S. HRG. 100-84

THE EXPORT-IMPORT BANK AND EXPORT PROMOTION

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

EXPORT PROMOTION PROGRAMS OF THE COMMERCE DEPARTMENT AND THE LENDING POLICIES OF THE EXPORT-IMPORT BANK INCLUDING BANK AND NONBANK AFFILIATED EXPORT TRADING COMPANIES

MARCH 25, 1987

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THE EXPORT-IMPORT BANK AND EXPORT PROMOTION

WEDNESDAY, MARCH 25, 1987

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,

Washington, DC.

The subcommittee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator Paul S. Sarbanes (chairman of the subcommittee) presiding.

Present: Senators Sarbanes, Proxmire, Dixon, Graham, and Heinz.

OPENING STATEMENT OF SENATOR SARBANES

Senator SARBANES. I am pleased to welcome you here this morning to this hearing on the export promotion programs of the Commerce Department and the lending policies of the Export-Import Bank. This is another in a series of hearings which this Subcommittee on International Finance and Monetary Policy has been holding in preparation for considering the Banking Committee's portion of legislation which will be related or pertaining to the Trade bill, which will be dealt with in the Senate in the next few months.

Last year the Congress passed the Export-Import Bank Act amendments which extended the Bank's charter for 6 years and set out a number of policy changes in the Bank's lending program.

We have had an opportunity, of course, to review those changes this morning. The Commerce Department is pursuing a range of export promotion programs to enhance the ability of U.S. business to sell abroad.

I would like the opportunity at this point to review those programs, including the operation of export trading companies, on which we will also hear from Manuel Johnson, the Vice Chairman of the Federal Reserve Board.

Gentlemen, I think we will include your full statements in the record as submitted to the committee, and if you could excerpt from them and make a presentation in something under 10 minutes, we would appreciate that very much.

Before we start, Senator Proxmire?

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you, Mr. Chairman.

Today you have assembled an excellent group of witnesses to talk about various export promotion devices, including the Export-Import Bank and bank and nonbank affiliated export trading companies. The full committee plans to mark up trade-related legislation in the latter part of April. We have a deadline of May 1, I understand on the Trade bill.

Export trading companies were made possible by Title II of the Export Trading Company Act in 1982. That title, known as the Bank Export Services Act, provides a limited exception to the nonbanking prohibitions in the Bank Holding Company Act, by letting bank holding companies and certain other types of banking organizations make equity investments in export trading companies.

Those provisions reflected a dramatic departure in our traditional practice of keeping banking organizations out of commercial ventures. In recognition of the potential risks to this expanded latitude, however, Congress included a number of prudent safeguards to limit the adverse financial effects on banks affiliated with export trading companies [ETC's] and charged the Federal Reserve to administer them.

Bank-affiliated export trading companies have not fulfilled the trading expectations of their supporters. Instead of facing up to and correcting their own internal shortcomings, that have caused them to fail to fulfill expectations, the banks blame the Federal Reserve.

Some claim the Fed is not administering the 1982 act properly and that the act needs to be expanded. The Fed rejects these charges and contends, the new inroads into commerce banks are now seeking will threaten bank safety. I note that the Japanese, because of their own concerns about the safety of their financial system, limit banks to only a 5-percent ownership share in trading companies. Smaller nonbank-affiliated export trading companies which account for a large portion of our exports, are also concerned about the Congress giving even greater advantages to bank-affiliated competitors.

We will hear more about these concerns from both the Federal Reserve and representatives of the smaller nonbank export companies during our hearing today.

Finally, Mr. Chairman, let me take this opportunity to congratulate John Bohn, President of the Export-Import Bank for the agreement recently reached in the Organization for Export Cooperation and Development [OECD] to limit the practice of using tied aid or mixed credits for trade promotion purposes. It would have been preferable, in my view, if the agreement had raised the grant element in mixed credits to 50 percent across-the-board instead of just for less developed nations. But I can understand the difficulties that must have been involved in the negotiations, and a 35 percent grant element should be sufficient to end the pernicious practice of using development assistance funds for trade promotion. It is also my hope that the OECD agreement means the Treasury Department and the Export-Import Bank will no longer need to draw on the mixed credit war chest that was authorized by Congress as part of last year's Eximbank renewal legislation.

After all, the justification for the war chest was that it was needed solely and exclusively to persuade others to reach the agreement that has now been achieved.

Thank you very much, Mr. Chairman.

Senator SARBANES. Senator Dixon?

Senator DIXON. Mr. Chairman, I have a statement I will place in the record, in the interest of time.

Senator SARBANES. It will be included in the record.

STATEMENT OF SENATOR ALAN DIXON

Mr. Chairman, I am pleased to be here this morning as the International Finance Subcommittee holds this hearing on the Export-Import Bank, export trading companies and export promotion programs. I look forward to the testimony of those officials involved in the formulation of lending policies of the Export-Import bank and those representatives of trading and export associations.

During the last few weeks this committee has heard from many distinguished members of government and the finance community of the need to improve the U.S. export performance. I remain committed to strong export promotion programs in the Department of Commerce, to the maintenance of an effective and competitive Export-Import Bank, and to continued development and improvement of the Export Trading Company Act.

As I have noted before, I believe that we must ensure that American companies have the opportunity and tools they need to compete effectively in a rapidly changing international marketplace. We can no longer afford to ignore the impact our export performance has on our overall economic health.

The 100th Congress has wisely dedicated itself to improving this Nation's trade policy and reducing the trade deficit. The subjects we are considering today have a significant role to play in helping us regain that competitive edge.

We will soon be marking up the Banking Committee's contribution to the Trade bill. I look forward to working with my colleagues and all interested parties to ensure that appropriate Export Trading Company Act and other reforms are included in the Banking Committee package.

Senator SARBANES. Mr. Good, I think we will start with you. Then we will go to Mr. Johnson and then Mr. Bohn.

We are pleased to hear from you. You might identify your colleague for the record.

STATEMENT OF ALEX GOOD, DIRECTOR GENERAL, UNITED STATES AND FOREIGN COMMERCIAL SERVICE, ACCOMPANIED BY DAVID LUFT, DEPUTY ASSISTANT SECRETARY OF COMMERCE FOR SERVICES

Mr. GOOD. Thank you very much, Mr. Chairman.

It is a privilege for me to be here today. I am delighted to have with me David Luft, Deputy Assistant Secretary for Services in the International Trade Administration and overseer of the Office of Export Trading Companies.

Pursuant to your instructions, sir, we will submit our complete statement for the record, and I will give a brief summary of where

we are and where we are going, including the export trading company issues.

MODIFYING AND IMPROVING SERVICES

Mr. Chairman, the United States and Foreign Commercial Service, which is the primary organization within the International Trade Administration for promotion of our exports overseas, is a relatively young organization. We were created from the State Department in 1981, and since that time have been modifying and improving what are our services, in order to enhance the effectiveness of the U.S. Government's export promotion efforts.

At this point, sir, we have 127 offices overseas in approximately 66 countries, acting as the service and delivery arm for our export promotion services overseas. We similarly have about 48 district offices and 19 branch offices.

We are a service organization, sir. We do a great deal in connection with market awareness, counseling exporters, providing commercial information. Because of that, it is absolutely critical that we have the best possible personnel. We have made a major recruitment effort to try to bring to the service employees with three specific talents and capabilities. One is private sector experience; two is, of course, appropriate academic background; and three is language capability.

At this point, sir, about 55 percent of our officers have a minimum of 3 years of private sector experience. We have a total of 770 years of private sector experience among our 180 American officers.

In connection with our academic background, 61 percent of our officers hold advanced degrees in either international business, law or economics. Seventy-eight percent of our officers speak at least one foreign language and 38 percent speak 2 or more.

We have made a specific concentration on finding speakers of oriental languages. We are currently seeking 15 Chinese speakers, 10 Japanese speakers, 7 Korean speakers and 6 Malayan-Thai speakers.

I think that is representative of what we are trying to do, in order to recruit the appropriate caliber of individual.

Overseas, not only do we represent the International Trade Administration [ITA], but we also work very closely with other agencies. We work very closely with the trade and development program, very closely with Mr. Bohn's agency, the Eximbank and very closely with the Overseas Private Investment Corporation [OPIC]. It is critical that our officers are not only well-versed on the issues that involve the International Trade Administration but other export promotion issues as well.

TRADITIONAL EXPORT PROMOTION ACTIVITIES

In addition to carrying out the traditional export promotion activities of the Department of Commerce, which include trade shows and trade events, we have moved into some other areas, more specifically into catalog shows, video catalog shows, very heavily into the foreign buyers' program, where we bring buyers from overseas to the United States trade shows. We recently had a number. I

think we had a record-showing of 700 French attending the Con Expo Show, the construction exhibition in Las Vegas. We are pushing those programs very aggressively.

We have also set up procedures to provide an early warning system for products coming out of the Multilateral Development Bank projects.

I should also tip my hat to Mr. Bohn here, because he had a great deal of responsibility for setting up the program and making the program work while he was at the Asian Development Bank.

We have expanded that program to the African Development Bank, the Inter-American Development Bank and the World Bank. Similarly, we cooperate with other organizations to make sure that our exporters get the benefit of Agency for International Development [AID] contracts, wherever possible. We also make sure that we are providing technical services through the National Bureau of Standards and the Corps of Engineers, the Bureau of Reclamation, the Bureau of Census and others, and that we turn those technical contacts into, hopefully, commercial contacts.

We are making an effort to provide the best and most up-to-date commercial information and are in the process of implementing a very sophisticated commercial information management system, an automated data system that will provide to our officers the tools and information they need to effectively counsel our exporters.

So our task and our mandate is, indeed, a broad one and covers many different areas.

In connection with the export trading companies, we work very closely with Mr. Luft's office. As a matter of fact, we have a working agreement in connection with Title I of the Export Trading Company Act of 1982, to provide a promotion throughout the United States, where we have at least one conference per region, each of our nine domestic regions, which we conducted in 1986 and continuing in 1987.

Similarly, we provide training for our officers on the advantages of export trading companies and what procedures are to follow to form export trading companies. We provide briefings, when requested by the private sector. And Mr. Luft's office was very aggressive in Washington and with our district offices throughout the United States, promoting the benefits of the Export Trading Company Act.

INADEQUATE PERFORMANCE ON BANK EXPORT TRADING COMPANIES

In connection with title II, we are all aware that—Mr. Chairman, you mentioned the shortcomings of the expectations for the bank export trading companies. We have identified a number of areas that have come to us, as we believe, partial explanations for what we believe are inadequate performance by bank export trading companies.

Secretary Baldrige, in September 1983 and then in September 1984, wrote to the Chairman of the Federal Reserve expressing the concerns that the Department of Commerce has with the current Federal Reserve Board regulations. We can go into that in some detail. We are pleased with Senator Heinz' legislation, S. 653 and

how it addressed some of what we believe are the critical shortcomings in connection with the bank export trading companies.

In connection with title III and the antitrust review, we received very good news in January when the third circuit unanimously upheld the Department of Commerce's position in providing antitrust certificates in the *Horizons* v. *Baldrige* case. We are now in a position of wanting to codify the whole thing and clarify the antitrust provisions and what protection is provided under the antitrust certificate.

So we will be moving with the administration bill, as well as working with this committee in connection with that review as well.

I might say that the administration has felt strongly enough about the reforms of the export trading company to provide them in our bill, S. 539, and we will be aggressively pushing to make the Export Trading Company Act meet everyone's expectations.

Mr. Chairman, let me just limit my remarks, very brief remarks. At an appropriate time, of course, we will be happy to take questions.

[The complete prepared statement of Alexander H. Good follows:]

TESTIMONY OF

ALEXANDER H. GOOD, DIRECTOR GENERAL, US&FCS

BEFORE THE

INTERNATIONAL FINANCE AND MONETARY POLICY SUBCOMMITTEE OF THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I AM ACCOMPANIED BY DAVID LUFT, DEPUTY ASSISTANT SECRETARY OF COMMERCE FOR SERVICES WHO HAS THE RESPONSIBILITY FOR THE DEPARTMENT'S EXPORT TRADING COMPANY PROGRAM.

I AM PLEASED TO HAVE THIS OPPORTUNITY TO DISCUSS THE EXPORT PROMOTION PROGRAMS OF THE DEPARTMENT OF COMMERCE AND CHANGES TO THE EXPORT TRADING COMPANY ACT. THE INTERNATIONAL TRADE ADMINISTRATION (ITA), AND PARTICULARLY THE U.S. AND FOREIGN COMMERCIAL SERVICE (US&FCS), IS IN A STRATEGIC POSITION TO PROMOTE AGGRESSIVELY U.S. EXPORTS. WITH 127 COMMERCIAL OFFICES IN 66 COUNTRIES AND 48 DISTRICT AND 19 BRANCH OFFICES IN THE UNITED STATES, THE US&FCS IS THE U.S. GOVERNMENT EXPORT PROMOTION ORGANIZATION WHICH CAN REPRESENT U.S. BUSINESS INTERESTS BOTH DOMESTICALLY AND ABROAD.

THE MISSION OF THE US&FCS IS TO PROMOTE U.S. EXPORTS, EXPAND THE NUMBER OF EXPORTERS, AND ASSIST U.S. COMPANIES IN THE INTERNATIONAL MARKETPLACE.

THERE ARE FOUR WAYS THAT WE COULD ACHIEVE THIS MISSION: 1) PROMOTE AWARENESS OF EXPORT POSSIBILITIES; 2) PROVIDE COUNSELING AND COMMERCIAL INFORMATION; 3) CONDUCT MARKET ASSISTANCE; AND 4) OFFER FINANCIAL SUPPORT. WHILE THE US&FCS CANNOT PROVIDE THE FINANCIAL SUPPORT TO U.S. FIRMS THAT OTHER ORGANIZATIONS LIKE EXIM BANK AND THE SMALL BUSINESS ADMINISTRATION (SBA) DO, WE DO PROVIDE THE AWARENESS BUILDING, COUNSELING, INFORMATION AND PROMOTIONAL OPPORTUNITIES THAT U.S. COMPANIES NEED TO RETAIN OR INCREASE THEIR COMPETITIVENESS IN INTERNATIONAL MARKETS.

SECRETARY BALDRIGE HAS POINTED OUT THE NEED FOR INNOVATIVE AND AGGRESSIVE INTERNATIONAL STRATEGIES BY U.S. EXECUTIVES AS ESSENTIAL TO COMPETING IN A CHALLENGING GLOBAL ECONOMY. WE IN THE US&FCS MUST ALSO BE INNOVATIVE AND AGGRESSIVE IF WE ARE TO MAKE OUR SERVICES MORE EFFECTIVE AND ACCESSIBLE TO U.S. FIRMS. WE ARE DOING SO. WE ARE INCREASING U.S FIRMS' AWARENESS OF EXPORTING, ENHANCING OUR OWN PRODUCTIVITY THROUGH THE USE OF THE COMMERCIAL INFORMATION MANAGEMENT SYSTEM (CIMS), IMPROVING OUR INFORMATION PRODUCTS AND TRADE EVENTS, AND WORKING MORE CLOSELY WITH THE STATES. AS A RESULT, THE US&FCS IS HELPING U.S. COMPANIES TO PENETRATE FOREIGN MARKETS, THEREBY CONTRIBUTING TO A BETTER U.S. TRADE BALANCE.

I WOULD NOW LIKE TO DESCRIBE SOME OF THE THINGS WE ARE DOING.

AWARENESS OF EXPORT POSSIBILITIES

TO PROMOTE EXPORTS, WE MUST INCREASE U.S. FIRMS' AWARENESS OF

OUR TRADE INFORMATION, CONTACT SERVICES AND PROMOTIONAL EVENT OFFERINGS. TO ACCOMPLISH THIS EFFICIENTLY, WE USE INDUSTRY TRADE ASSOCIATIONS, PRIVATE SECTOR PUBLICATIONS AND OTHER KEY MULTIPLIERS, TO REACH THE BROADEST AUDIENCE.

WE ARE WORKING WITH THE AD COUNCIL, A NON-PROFIT ORGANIZATION, TO DEVELOP AN AGGRESSIVE EXPORT AWARENESS CAMPAIGN AIMED AT THE U.S. BUSINESS COMMUNITY. ADS URGING U.S. FIRMS "SEND YOUR HEARTS TO SEOUL", AND "SEND YOUR SLINGS TO SINGAPORE" HAVE BEEN DISTRIBUTED TO 3,500 MAJOR DAILY NEWSPAPERS, BUSINESS PUBLICATIONS AND TRADE JOURNALS AND BEGAN RUNNING IN JANUARY, 1987. TO DATE APPROXIMATELY 20 NEWSPAPERS HAVE VOLUNTEERED SPACE FOR THESE ADS. TO RESPOND TO INQUIRIES GENERATED BY THESE ADS, WE NOW HAVE A TOLL-FREE 800 TELEPHONE NUMBER.

WE ALSO PRODUCE A VARIETY OF PUBLICATIONS TO LET U.S. BUSINESS KNOW MORE ABOUT THE ADVANTAGES OF EXPORTING, SOURCES OF EXPORT FINANCING AND ASSISTANCE, AND THE VARIETY OF TRADE INFORMATION, CONTACT SERVICES AND PROMOTIONAL TECHNIQUES AVAILABLE. A GOOD EXAMPLE IS THE NEWLY REVISED BASIC GUIDE TO EXPORTING. THE GUIDE, A "HOW-TO" MANUAL ON THE MECHANICS OF EXPORTING, PROVIDES A STARTING POINT FOR NEW-TO-EXPORT COMPANIES AS WELL AS AN EXPLANATION OF SOME OF THE FINER POINTS OF EXPORTING AND EXTENSIVE SOURCES OF INFORMATION FOR EXPERIENCED EXPORTERS. WE WERE ABLE TO GET FREE PUBLICITY FOR THE NEW GUIDE IN THE FEBRUARY 10, 1987, "MONEY" SECTION OF USA TODAY, WHICH REACHED FOUR MILLION READERS. THE BUSINESS COMMUNITY'S RESPONSE IS ENTHUSIASTIC.

ON AN ON-GOING BASIS, WE ARE MAKING USE OF PROMOTIONAL TECHNIQUES, SUCH AS DIRECT-MAIL CAMPAIGNS, TARGETED ARTICLES IN INDUSTRY PUBLICATIONS, PIGGY-BACK ADVERTISING, PUBLIC SERVICE RADIO SPOTS. WE HAVE ENTERED INTO AN AGREEMENT WITH USIA TO PROMOTE UP TO FOUR FOREIGN BUYER PROGRAM EVENTS DURING 1987 THROUGH WORLDNET BROADCASTS. IN JANUARY, THE FIRST OF THESE SHOWCASED THE UPCOMING NATIONAL ASSOCIATION OF BROADCASTERS SHOW AND INTERNATIONAL EXPOSITION TO STANDING-ROOM-ONLY CROWDS OF TOP BROADCAST INDUSTRY PROFESSIONALS AND JOURNALISTS GATHERED IN U.S. EMBASSIES IN EUROPE AND LATIN AMERICA. MANY OF THE ATTENDEES SIGNED UP ON THE SPOT TO ATTEND THE EVENT.

WE ARE ALSO WORKING WITH WANG LABORATORIES OF LOWELL MASSACHUSETTS TO DEVELOP COOPERATIVE ADVERTISING TO PROMOTE OUR NEW COMMERCIAL INFORMATION MANAGEMENT SYSTEM (CIMS). INC. AND BUSINESS WEEK MAGAZINES ARE INTERESTED IN WORKING WITH US TO PROMOTE CIMS. IF WE ARE SUCCESSFUL, THESE EFFORTS WILL GIVE US THE NATIONAL EXPOSURE TO PROSPECTIVE EXPORTERS THAT WE NEED, AT NO COST TO THE GOVERNMENT.

ONE DILEMMA WE FACE IN BUILDING EXPORT AWARENESS IS THE DANGER OF CREATING A DEMAND FOR EXPORT ASSISTANCE THAT WE CANNOT MEET. FOR THIS REASON WE ARE MAKING GOOD USE OF STATES, 51 DISTRICT EXPORT COUNCILS (DECS), AND OTHER MULTIPLIERS SUCH AS LOCAL CHAMBERS OF COMMERCE.

THE DECS ARE A POWERFUL FORCE IN PROMOTING GREATER AWARENESS OF

EXPORTING. WORKING CLOSELY WITH THEM AND OTHER MULTIPLIERS, WE WILL STAGE OVER 3,400 DOMESTIC SEMINARS THIS YEAR, ON SUBJECTS RANGING FROM THE BASICS OF HOW TO EXPORT TO SPECIAL COUNTRY-ORIENTED TOPICS. FOR THE RECORD, I AM INCLUDING A LIST OF THESE SEMINARS.

THE 900-PLUS ASSOCIATE OFFICES -- LOCAL CHAMBERS OF COMMERCE AND OTHER BUSINESS-ORIENTED ORGANIZATIONS -- ALSO PLAY AN IMPORTANT ROLE IN BUILDING EXPORT AWARENESS, CHANNELING COMMERCE EXPORT INFORMATION AND PUBLICATIONS, SUCH AS COMMERCE BUSINESS DAILY, BUSINESS AMERICA, THE INDUSTRIAL OUTLOOK AND STATISTICAL ABSTRACT, TO THEIR MEMBERS.

COUNSELING AND COMMERCIAL INFORMATION

PROFESSIONAL EXPORT COUNSELING IS ONE OF THE MOST IMPORTANT THINGS WE DO TO PROMOTE EXPORTS. THIS YEAR OUR DISTRICT OFFICE TRADE SPECIALISTS WILL CONDUCT MORE THAN 143,000 COUNSELING SESSIONS WITH INDIVIDUAL FIRMS, ASSOCIATE OFFICES, AND STATE AND LOCAL GOVERNMENT ORGANIZATIONS. OVERSEAS, SENIOR COMMERCIAL OFFICERS AND FOREIGN SERVICE NATIONALS WILL CONDUCT ANOTHER 125,000 COUNSELING SESSIONS.

TO COMPETE IN WORLD MARKETS, U.S. FIRMS MUST HAVE ACCESS TO TIMELY AND ACCURATE COMMERCIAL INTELLIGENCE ON OVERSEAS MARKET OPPORTUNITIES. S.539, THE TRADE, EMPLOYMENT, AND PRODUCTIVITY ACT OF 1987, RECOGNIZES THIS NEED. COMPUTERIZATION IS ESSENTIAL IF WE ARE TO COLLECT AND DISSEMINATE THIS INFORMATION EFFICIENTLY. OUR NEW COMMERCIAL INFORMATION MANAGEMENT SYSTEM (CIMS) WILL PROVIDE COMMERCIAL INFORMATION SPECIFICALLY DESIGNED TO ADDRESS THE SPECIAL NEEDS OF U.S. BUSINESSES.

CIMS WILL:

-- AUTOMATE THE COLLECTION OF MARKETING INFORMATION OVERSEAS, IMPROVING THE EFFICIENCY OF OUR COMMERCIAL INTELLIGENCE GATHERING CAPABILITY AND THE QUALITY AND ORGANIZATION OF THAT INFORMATION;

-- IMPROVE ITA'S ABILITY TO ANALYZE AND INTERPRET INFORMATION ON OVERSEAS MARKETS TO SUPPORT TRADE PROMOTION PLANNING AND TRADE POLICY INITIATIVES; AND

-- DELIVER TIMELY, USEFUL INFORMATION ON OVERSEAS MARKETS, TRADE CONTACTS AND EXPORT SALES OPPORTUNITIES ELECTRONICALLY THROUGH OUR DISTRICT OFFICES TO THE U.S. BUSINESS COMMUNITY, AND TO FEDERAL AND STATE GOVERNMENT USERS.

EVEN BEFORE CIMS IS OPERATIONAL, THE POSITIVE EFFECTS OF AUTOMATION ARE APPARENT. NEW CIMS HARDWARE HAS INCREASED THE PRODUCTIVITY OF US&FCS EMPLOYEES -- OVERSEAS, IN HEADQUARTERS, AND DOMESTICALLY. THE ONLY REMAINING COMPONENT, NEW SOFTWARE, IS ALMOST COMPLETE. WITH IT, WE WILL IMPROVE ACCESS TO

INFORMATION BY INTERNAL USERS, SPEED THE FLOW OF INFORMATION TO THE BUSINESS COMMUNITY AND SIGNIFICANTLY ENHANCE THE COUNSELING CAPABILITY OF OUR OFFICERS BY PROVIDING THEM WITH THE TOOLS AND THE INFORMATION TO CUSTOM-TAILOR INFORMATION TO THE NEEDS OF U.S. COMPANIES.

TRAINING IS ESSENTIAL TO ACHIEVE THE POTENTIAL OF CIMS. RIGHT NOW OUR DISTRICT OFFICE TRADE SPECIALISTS AND OVERSEAS STAFF ARE PARTICIPATING IN EXTENSIVE IN-HOUSE COMPUTER LITERACY TRAINING TO LEARN THE SKILLS THEY NEED TO ACCESS AND UTILIZE TRADE INFORMATION STORED ELECTRONICALLY. THE NEXT STAGE INVOLVES HANDS-ON EXPERIENCE WITH CIMS SOFTWARE.

IN PREPARATION FOR CIMS, WE ARE RETHINKING THE CONTENT OF THE INFORMATION PRODUCTS AND SERVICES THAT IT WILL DELIVER. IN THE PAST, MOST INFORMATION PRODUCTS WERE AVAILABLE ONLY IN STANDARDIZED OFF-THE-SHELF PRINTED FORM, REQUIRED MAIL-INTENSIVE DELIVERY, OFTEN HAD A BROAD INDUSTRY ORIENTATION, AND VARIED WIDELY IN QUALITY AND TIMELINESS.

IN THE PAST YEAR WE HAVE CONCENTRATED ON REDUCING OUR RELIANCE ON OFF-THE-SHELF PRODUCTS, REDESIGNING PRODUCTS SO THAT THEY OFFER MORE COMPANY AND SUB-SECTOR SPECIFIC INFORMATION, AND REFORMATTING OUR RESEARCH TO PREPARE FOR ELECTRONIC DISSEMINATION.

TO ECONOMIZE ON PRINTING AND STORAGE OF PAPER PRODUCTS, SUCH AS OUR MARKET RESEARCH, WE HAVE BEGUN CONVERTING THE INFORMATION FOR ON-LINE DELIVERY. RIGHT NOW OUR DISTRICT OFFICE TRADE SPECIALISTS CAN ACCESS OVER 5,500 MARKET RESEARCH ABSTRACTS USING AN ELECTRONIC MAIL NETWORK.

WE HAVE NARROWED THE FOCUS OF OUR RESEARCH FROM BROAD INDUSTRY REVIEWS TO PRODUCT- AND SUB-SECTOR SPECIFIC STUDIES, INCREASING ITS VALUE TO THE BUSINESS COMMUNITY AND INTERNAL ITA USERS.

WE ALSO DEVELOPED A NEW SERVICE CALLED COMPARISON SHOPPING. IT PROVIDES A FIRM WITH CONCISE ANSWERS TO KEY QUESTIONS ON ITS OWN PRODUCT: OVERALL MARKETABILITY; NAMES OF COMPETITORS; COMPARATIVE PRICES; CUSTOMARY ENTRY, DISTRIBUTION AND PROMOTION PRACTICES; FACTORS THAT MAY INFLUENCE COMPETITIVENESS; AND INFORMATION ON TRADE BARRIERS. EVEN THOUGH THIS SERVICE IS AVAILABLE IN JUST 15 COUNTRIES, THE RESPONSE OF THE BUSINESS COMMUNITY IS ENTHUSIASTIC -- 97 HAVE BEEN PERFORMED SINCE THE PROGRAM BEGAN LESS THAN A YEAR AGO.

A MAJOR FACTOR IN THE SUCCESS OF THIS PROGRAM IS OUR MANAGERS OF RESEARCH AND ANALYSIS -- FOREIGN SERVICE NATIONALS OR CONTRACT HIRES WHO ARE SPECIALLY TRAINED IN RESEARCH TECHNIQUES. THEY PERFORM IN-COUNTRY RESEARCH, INCLUDING COMPARISON SHOPPING SURVEYS, AND PROVIDE A MUCH NEEDED EXPANSION OF OUR IN-HOUSE RESEARCH CAPABILITY AT SELECTED OVERSEAS POSTS. WE HOPE TO EXPAND OUR USE OF MRA'S TO ADDITIONAL COUNTRIES.

MARKET CONTACT SERVICES

IN ADDITION TO IMPROVING OVERSEAS MARKET INFORMATION, WE ARE REVIEWING OUR EXISTING CONTACT AND ASSISTANCE SERVICES, IN ORDER TO IMPROVE THEIR USEFULNESS TO U.S. FIRMS.

- TRADE OPPORTUNITIES PROGRAM

  WE ARE REDESIGNING THIS PROGRAM, USING NEW SOFTWARE TO IMPROVE: 1) THE QUALITY OF TRADE LEADS BY EXPANDING THE PRODUCT DESCRIPTION; 2) OUR ABILITY TO MATCH BUYER AND SELLER BY SUBSTITUTING KEY WORDS FOR SIC CODES; AND 3) INCREASE THE NUMBERS OF FIRMS THAT RECEIVE THEM. THE NEW TRADE LEAD SERVICE WILL PROVIDE EXPEDITED TREATMENT IN THE FIELD TO ENCOURAGE FIRMS TO ACT ON THE LEADS THEY RECEIVE.

  AGENT DISTRIBUTOR SERVICE, WORLD TRADERS DATA REPORTS, AND EXPORT MAILING LISTS

  TRADITIONAL SERVICES SUCH AS THESE WILL BENEFIT FROM AUTOMATION. HERE AGAIN, KEY WORD SEARCH CAPABILITIES AND ELECTRONIC ACCESS WILL INCREASE THE USEFULNESS OF THIS INFORMATION.

  COMMERCIAL NEWS USA

  WE HAVE RECENTLY IMPROVED THIS PUBLICATION, WHICH PROMOTES THE PRODUCTS AND SERVICES OF U.S. NEW-TO-EXPORT, NEW-TO-MARKET FIRMS TO INTERESTED OVERSEAS AGENTS, DISTRIBUTORS, END-USERS, AND FOREIGN GOVERNMENT PURCHASING OFFICIALS. COMMERCIAL NEWS USA, A MONTHLY PUBLICATION, IS PRODUCED ON A 100 PERCENT COST RECOVERY BASIS. RECENTLY, WE ADOPTED A LESS EXPENSIVE FORMAT AND MADE OTHER CHANGES WHICH INCREASED OVERSEAS DISTRIBUTION FROM 2,500 TO 90,000. IN ADDITION, EXCERPTS FROM THE MAGAZINE ARE REPRINTED IN SEVERAL PRIVATE PUBLICATIONS, SUCH AS THE ECONOMIC DAILY NEWS IN TAIWAN, A BUSINESS PUBLICATION CIRCULATED DAILY TO 200,000 READERS.

- INTERNATIONAL DEVELOPMENT BANK PROJECT ALERTS: OVER THE LAST TWO YEARS WE HAVE GREATLY EXPANDED THE FLOW OF EARLY WARNING NOTICES TO U.S. ENGINEERING FIRMS AND EQUIPMENT SUPPLIERS FOR PROJECTS FINANCED BY THE ASIAN AND AFRICAN DEVELOPMENT BANKS. OUR SENIOR COMMERCIAL OFFICERS IN MANILA AND ABIDJAN REGULARLY SUPPLY PROJECT INFORMATION AND UPDATES TO OUR DISTRICT OFFICES AND OVERSEAS COMMERCIAL STAFF. WORKING WITH TRADE DEVELOPMENT'S MAJOR PROJECT DIVISION, WE HAVE ESTABLISHED A SIMILAR CAPABILITY WITH THE WORLD BANK AND INTER-AMERICAN DEVELOPMENT BANK, HERE IN WASHINGTON. IN ADDITION TO PROVIDING CONTACT INFORMATION, WE OFTEN GET DIRECTLY INVOLVED. IN ARGENTINA, FOR EXAMPLE, THE US&FCS, TWICE INTERVENED WITH ARGENTINE PROCUREMENT AUTHORITIES TO SAVE A $16 MILLION AWARD FOR AN ENERGY MANAGEMENT SYSTEM FINANCED BY THE IDB FOR THE FERRANTI COMPANY OF AUSTIN, TEXAS.

TRADE EVENTS

WE OFFER U.S. BUSINESSES A VARIED MENU OF TRADE PROMOTION EVENTS TO SHOWCASE THEIR PRODUCTS TO OVERSEAS SALES PROSPECTS: TRADE FAIRS, TRADE AND SEMINAR MISSIONS, CATALOG/VIDEO CATALOG SHOWS, AND BUSINESS INFORMATION OFFICES.

LAST YEAR, OVER 2,700 FIRMS PARTICIPATED IN ITA TRADE EVENTS, WHICH ARE RUN ON A COST RECOVERY BASIS. ALTHOUGH FIRMS ARE OFTEN RELUCTANT TO PROVIDE INFORMATION ON THEIR RESULTS, $180 MILLION IN OFF-THE-FLOOR SALES, 141,000 TRADE LEADS, AND OVER 1,600 AGENT, LICENSE AND JOINT VENTURE AGREEMENTS WERE REPORTED.

WE NEED TO GET MORE FIRMS, PARTICULARLY SMALL- AND MEDIUM-SIZED ONES, TO PARTICIPATE IN TRADE EVENTS. A KEY STRATEGY FOR ACCOMPLISHING THIS IS TO INCREASE VALUE WHILE KEEPING COSTS REASONABLE. A GOOD EXAMPLE IS OUR MATCHMAKER PROGRAM -- SPECIAL DELEGATIONS OF U.S. BUSINESSPERSONS PLANNED, ORGANIZED AND LED BY US&FCS OFFICERS. MATCHMAKERS BRING NEW-TO-EXPORT OR NEW-TO-MARKET FIRMS INTO CONTACT WITH AGENTS, DISTRIBUTORS, LICENSEES, FRANCHISEES OR JOINT VENTURE PARTNERS AND INCLUDE APPOINTMENTS AND SPECIALLY PROGRAMMED SEMINARS. WHILE THE EVENTS ARE EXECUTED ON A FULL COST RECOVERY BASIS, WE MAKE EVERY EFFORT TO MAKE THE EVENTS ECONOMICAL TO ENCOURAGE SMALL- TO MEDIUM-SIZED FIRMS TO PARTICIPATE.

OUR RECENT MATCHMAKERS '86, IN LONDON, GAVE 37 SMALL- AND MEDIUM-SIZED HIGH TECH ELECTRONIC EQUIPMENT COMPANIES THE OPPORTUNITY TO MEET 500 BRITISH BUSINESS REPRESENTATIVES CAREFULLY SELECTED BY US&FCS LONDON. EARLY RESULTS SHOW THAT 21 REPRESENTATION/AGENCY AGREEMENTS WERE SIGNED, 8 LICENSING AGREEMENTS WERE NEGOTIATED, 10 JOINT VENTURE PARTNERS WERE IDENTIFIED, $700,000 IN EQUIPMENT WAS SOLD OFF-THE-FLOOR, AND POTENTIAL 12-MONTHS' SALES OF $6 MILLION ARE EXPECTED.

WE ARE ALSO DOING MORE TO COORDINATE OVERSEAS TRADE PROMOTION ACTIVITIES WITH TRADE POLICY INITIATIVES. A GOOD EXAMPLE OF THIS IS JAPAN. WE ARE NOW PLANNING A MAJOR EXHIBITION IN MAY IN SUPPORT OF THE KANSAI AIRPORT PROJECT. A VARIETY OF OTHER PROMOTIONAL EVENTS HAVE ALSO BEEN IDENTIFIED WHICH WILL FOCUS ON KEY EXPORT SECTORS. US&FCS JAPAN HAS INITIATED A NEW PROMOTION PROGRAM TO BYPASS TRADITIONAL JAPANESE DISTRIBUTION SYSTEMS AND FACILITATE ENTRY OF U.S. PRODUCTS INTO THE JAPANESE CHAIN STORE NETWORK AT COMPETITIVE PRICES. A 500-STORE "AMERICAN FAIR" SUPPORTED BY THE US&FCS WILL PROMOTE U.S. PRODUCTS PURCHASED BY THE CHAIN STORES; AND TWO JAPANESE WHOLESALE BUYING GROUPS HAVE REQUESTED SUPPORT FOR THEIR BUYING MISSIONS TO THE U.S. THIS SPRING.

WE RECOGNIZE THE ROLE OF THE PRIVATE SECTOR IN TRADE PROMOTION AND STRONGLY SUPPORT A WIDE VARIETY OF PRIVATELY SPONSORED OR ORGANIZED EVENTS USING THEM TO LEVERAGE OUR RESOURCES. THIS YEAR, WE PLAN: 15 FOREIGN BUYER PROGRAM EVENTS; 25 OVERSEAS CERTIFIED EVENTS; AND 38 STATE OR INDUSTRY ORGANIZED GOVERNMENT APPROVED (S/IOGAS) TRADE MISSIONS.

MANY U.S. FIRMS ARE RELUCTANT TO PARTICIPATE IN OVERSEAS TRADE SHOWS, CITING THE HIGH COST OF TRAVEL, FREIGHT AND TIME

INVOLVED. TO REACH THESE FIRMS, MANY OF WHOM HAVE PRODUCTS OR SERVICES WITH EXPORT POTENTIAL, WE REINSTITUTED A NEW AND IMPROVED FOREIGN BUYER PROGRAM(FBP) LAST YEAR. THIS PROGRAM BRINGS TOGETHER AMERICAN FIRMS WITH QUALIFIED FOREIGN BUYERS AT U.S. TRADE SHOWS. THE US&FCS SELECTS LEADING U.S. TRADE SHOWS IN INDUSTRIES WITH HIGH EXPORT POTENTIAL TO PARTICIPATE IN THE PROGRAM. FIRMS EXHIBITING AT THESE SHOWS MEET QUALIFIED FOREIGN BUYERS, AGENTS/DISTRIBUTORS, AND POTENTIAL LICENSEE OR JOINT VENTURE PARTNERS.

THE US&FCS PROVIDES THESE FIRMS WITH EXPORT COUNSELING AND COUNTRY-SPECIFIC MARKETING INFORMATION IN ADVANCE OF THE SHOW AS WELL AS ON-SITE. THIS YEAR, WE HAVE EXPANDED THE NUMBER OF FOREIGN BUYER PROGRAM SHOWS AND EXPECT OVER 2,700 FIRMS TO PARTICIPATE IN SPECIAL FBP EXPORT INTEREST DIRECTORIES. MORE THAN ONE-THIRD OF THESE FIRMS WILL RECEIVE SPECIAL PRE-SHOW EXPORT COUNSELING FROM OUR DOMESTIC TRADE SPECIALISTS. OVER 51,000 FOREIGN BUSINESS VISITORS WILL TRAVEL TO THE U.S. IN GROUP VISITS UNDER THE PROGRAM.

IN ADDITION TO THE EVENTS THAT WE PLAN AND ORGANIZE, WE SUPPORT PRIVATE SECTOR TRADE SHOW ORGANIZERS OF SELECTED OVERSEAS EVENTS THOUGH THE TRADE FAIR CERTIFICATION PROGRAM. THIS TECHNIQUE HAS PROVEN VERY SUCCESSFUL IN THE PEOPLE'S REPUBLIC OF CHINA. EXPO-HITECH SHANGHAI '86, GAVE 35 U.S. COMPANIES PRIME EXPOSURE TO HIGH LEVEL CHINESE PURCHASERS -- IN FACT, 85 PERCENT OF THE EQUIPMENT SHOWN WAS SOLD OFF-THE-FLOOR.

A KEY STRATEGY FOR MAKING THE MOST OF OUR RESOURCES IS TO MAKE THE STATES A REAL PARTNER IN OUR PROMOTION ACTIVITIES. IN MANY INSTANCES, STATES HAVE BOTH THE RESOURCES AND MOTIVATION TO BE AGGRESSIVE TRADE PROMOTION AGENTS. THE FOCUS OF OUR EFFORTS IS A PILOT FEDERAL-STATE PROGRAM.

WORKING WITH THE NATIONAL ASSOCIATION OF STATE DEVELOPMENT AGENCIES, WE ARE INVOLVED IN A WIDE VARIETY OF COOPERATIVE VENTURES WITH SEVEN STATES, RANGING FROM CO-LOCATION OF OFFICES IN CONNECTICUT TO SHARING OF DATA BASES WITH NEW YORK'S STATE DEPARTMENT OF COMMERCE. WE ALSO:

- CO-SPONSOR INTERNATIONAL TRADE CONFERENCES WITH STATES.
- PROVIDE PLANNING AND OVERSEAS LOGISTICAL SUPPORT TO STATE AND INDUSTRY-ORGANIZED GOVERNMENT APPROVED MISSIONS, WRAPPING MISSIONS AROUND HIGH EXPORT POTENTIAL THEMES IDENTIFIED BY OUR COMMERCIAL OFFICERS OVERSEAS WHEREVER POSSIBLE.
- PIGGY-BACK ON STATE EXPORT PUBLICATIONS SUCH AS NEWSLETTERS, AND FORM JOINT PARTNERSHIPS TO DISSEMINATE INFORMATION. CURRENTLY NINE STATE AND LOCAL EXPORT DEVELOPMENT AGENCIES RECEIVE TRADE OPPORTUNITIES ELECTRONICALLY ON A DAILY BASIS.

THIS STRATEGY BUILDS ON THE GROWING CAPABILITIES OF STATES AS EXPORT MULTIPLIERS. THE STATE OF CONNECTICUT IS AN EXAMPLE OF HOW WELL THIS APPROACH CAN WORK.

Senator SARBANES. Thank you.

Mr. Johnson, if you would proceed. I have looked over your statement. I think it is a very thoughtful and pointed one. To the extent that you can direct your comments to the legislative proposals that might be before us, I think it would be particularly helpful.

Go ahead, sir.

STATEMENT OF MANUEL JOHNSON, VICE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. JOHNSON. Thank you, Mr. Chairman.

I will also try to limit my remarks to the 10-minute time limit and summarize my prepared statement.

First, as you know the purpose of the Bank Export Service Act was to develop bank-affiliated export trading companies to facilitate the trade or the export of goods and services produced in the United States. In the spirit of that act, the Federal Reserve sought to develop criteria by which to administer the Bank Export Services Act.

SUPERVISING EXPORT TRADING COMPANIES

So we have designed several criteria for supervising export trading companies affiliated with bank holding companies.

The purpose in designing these export trading companies was to facilitate exports, and in that sense, the act provided a very specific divergence from the separation of banking and commerce in which it allowed for a very specific type of commercial function through the export trading company. The Act allowed very limited functions, mainly associated with financing of goods and services that were exported from the United States abroad and the possibility of taking delivery of goods and services for resale abroad.

In that spirit, we designed a revenue test to determine whether export trading companies were fulfilling this function, by simply looking at the revenues associated specifically with the facilitation of exports. Therefore, we provided a revenue test that required that at least 50 percent of revenues of export trading companies had to come from the facilitation of exports, specifically. We think that this is in the spirit of the Export Trading Company Act and the export trading company itself, because the act is designed to facilitate exports, not trade per se.

I think that was our view, that we wanted to make sure that this entity was facilitating exports specifically and not just generalized trade, which could be imports or third country trade that would not be related to U.S. exports.

So we only counted as revenue, for the 50-percent revenue test, revenues associated with the export of goods and services and not third country trade, no revenues from that or import revenues.

I think there is maybe a little bit of room for flexibility in this area. I think there have been some proposals on the House side that have indicated that there may be a need for some for export trading companies to adjust and meet the 50-percent revenue test because of the learning curve, in which it takes time for export trading companies to develop expertise, but I think that we would

still feel strongly that a 50-percent revenue test associated with export revenues would still be the primary test.

LIMITATION ON LOANS TO EXPORT TRADING COMPANIES

Another very important issue, I think, in the exporting trading company area is the limitation on lending by a bank affiliate to the export trading company.

We have rules under section 23A of the Federal Reserve Act, that strictly limits lending by the affiliated bank to the export trading company or any other nonbank affiliate. That requires that loans to affiliated organizations, to all nonbank affiliated organizations be fully collateralized and that specific lending limitations with respect to total capital be required.

We support strongly the section 23A rules. We have made some slight exceptions in terms of trying to be flexible on lending limitations to export trading companies.

We have made the exception that we would reduce the requirement that demands greater than 100 percent collateral be provided on a loan to an export trading company down to 100 percent of the loan—so we have shown some flexiblity on our collateral requirements.

100 PERCENT COLLATERAL REQUIREMENT

But generally we stick with the section 23A collateral requirements on lending to export trading companies by affiliated banks. This is a very important issue because it gets to the heart of the safety and soundness issue with bank-affiliated export trading companies.

I think it would be very damaging to liberalize the lending limitations to nonbank affiliates, export trading companies being one of those, when we are trying to insulate the use of insured deposits and all the other safety net features that are provided to the banking organization.

It is very important that nonbank affiliates be subject to a market test and not be subsidized by lending from the affiliated banking institution. You could get into potentially highly risky situations if bank affiliates are subsidizing the financing of the nonbank affiliates in the form of export trading companies and these trading companies have the ability to leverage off of loans received from a bank affiliate.

So I think we have to be very careful there.

In addition to that, I think we have to be careful about the capitalization of nonbank affiliates, and we have been careful to expect export trading companies to be capitalized at least according to the industry capitalization of nonbank-related export trading companies. That has normally been around 25 percent of capital to assets.

Senator HEINZ. Twenty-five percent?

Mr. JOHNSON. Our surveys indicate that the industry average of nonbank-affiliated organizations is around 25 percent capitalization. It varies, but that is what we see as an industry average.

Now, we have approved the leveraging ratios for export trading companies up to 17 to 1, and so we have shown flexibility in this area. When you see export trading companies providing services

that look very much like traditional banking functions in terms of financing exports, we have reduced the capitalization limitation down close to that of the banking organization itself.

So we look at the capitalization on a case-by-case basis, but we would expect on average these organizations to be capitalized similar to the nonbank-related export trading companies.

And I think this is very important because there is a potential safety and soundness question for the banking system if we get into subsidized lending from the bank affiliate to the export trading company, and that combines with very high leveraging ratios that could present a potential safety and soundness question, and I think we have to be very careful there. So it is very important to be careful in the areas of capitalization and lending limitations from the bank affiliate.

These two issues, the capitalization and the lending limitation, raise a very important question about competitive equity. If we relax these particular requirements and allow lending from banks to their nonbank affiliates, like export trading companies, and not require full collateralization, we will be subsidizing the financing of these organizations. If we relax the capitalization requirements below industry standards, then we would be further relaxing those standards, and in fact those companies would not have to meet the market test.

If these export trading companies could not obtain financing in the market and had to go to financing from their bank affiliate they are not really having to meet a market test. Now, it may be true that they choose to do business with their bank affiliate and also meet a market test, but that is what we want to make sure is the case.

Those, then, are the major issues associated with export trading companies from the Federal Reserve point of view. I think we are certainly willing to try to work in the spirit of the Bank Export Services Act, but that has to be consistent in our minds with safety and soundness of the banks.

[The complete statement of Manuel H. Johnson, Jr. follows:]

IN 1986, CONNECTICUT PASSED LEGISLATION PROVIDING DIRECT LOANS TO EXPORTERS. OUR HARTFORD DISTRICT OFFICE COOPERATED CLOSELY WITH THE CONNECTICUT DEPARTMENT OF ECONOMIC DEVELOPMENT IN DEVELOPING THE LEGISLATION. THE DISTRICT OFFICE IS NOW HELPING THE STATE DEVELOP IMPLEMENTING REGULATIONS.

WE ARE ALSO WORKING WITH VARIOUS ELEMENTS OF THE DEPARTMENT OUTSIDE ITA TO IDENTIFY WAYS TO COOPERATIVELY PROMOTE EXPORTS. FOR EXAMPLE, AS PART OF THE PRESIDENT'S TRADE POLICY INITIATIVE, THE US&FCS AND THE NATIONAL BUREAU OF STANDARDS ARE POOLING THEIR COMBINED EXPERTISE AND WORLDWIDE CONTACTS IN INNOVATIVE WAYS. AS THE BUREAU ASSISTS DEVELOPING COUNTRIES IN ESTABLISHING THEIR OWN NATIONAL LABORATORIES, OUR US&FCS FOREIGN SERVICE OFFICERS WILL SEE TO IT THAT U.S. MANUFACTURERS OF NEEDED EQUIPMENT ARE ALERTED TO THESE EXPORT OPPORTUNITIES.

HOW IT ALL FITS TOGETHER

HOW DO OUR AWARENESS BUILDING, COUNSELING AND INFORMATION, AND TRADE EVENT ACTIVITIES ALL FIT TOGETHER? LET ME CITE, AS AN EXAMPLE, A CLIENT OF OUR CHICAGO DISTRICT OFFICE: THE AMERICAN HARDWARE MANUFACTURERS ASSOCIATION (AHMA).

AHMA'S INTEREST IN EXPORTING BEGAN IN 1980 WHEN THE DIRECTOR OF THE CHICAGO DISTRICT OFFICE WAS A FEATURED PANELIST AT THE FIRST AHMA SPONSORED EDUCATIONAL SEMINAR ON EXPORTING.

IN 1981 AHMA BECAME A CHARTER MEMBER OF THE HOUSEHOLD PRODUCTS EXPORT COUNCIL, FORMED UNDER THE AUSPICES OF THE US&FCS DISTRICT OFFICE.

IN 1982, AHMA WORKED WITH ITA TO RECRUIT A SPECIAL ISSUE OF COMMERCIAL NEWS USA DEVOTED TO HOUSEHOLD CONSUMER GOODS. MORE THAN 350 FIRMS PARTICIPATED, ONE OF THE MOST SUCCESSFUL ISSUES EVER.

IN 1983, AHMA BEGAN SPONSORING THE USA HARDWARE PAVILION AT THE COLOGNE INTERNATIONAL HARDWARE TRADE FAIR, THE LARGEST NON-U.S. INDUSTRY EVENT IN THE WORLD.

IN 1986, AHMA STAGED A BRITISH HARDLINES TRADE MISSION, AT THE INTERNATIONAL MARKETING CENTER OF THE U.S. EMBASSY IN LONDON, WITH THE FULL SUPPORT OF OUR COMMERCIAL SECTION. FIFTEEN U.S. COMPANIES PARTICIPATED IN THE MISSION, WHICH INCLUDED A TWO-DAY TRADE FAIR, COMPREHENSIVE BRIEFING FROM INDUSTRY EXPERTS, A PRODUCT EXHIBITION, AND A ONE-DAY TOUR OF RETAIL HARDLINES OUTLETS. IT WAS SO SUCCESSFUL A FOLLOW-UP EVENT IS PLANNED FOR THIS YEAR.

AHMA SPONSORS TWO INTERNATIONAL EVENTS, HARDWARE INDUSTRY WEEK AND THE NATIONAL HARDWARE SHOW, BOTH OF WHICH WERE CERTIFIED BY

ITA'S TRADE FAIR CERTIFICATION PROGRAM. DISTRICT OFFICE PERSONNEL AND A REPRESENTATIVE FROM ITA'S OFFICE OF CONSUMER GOODS ARE REGULAR PARTICIPANTS AT THIS SHOW, ASSISTING AHMA TO EVALUATE ITS PROGRAMS, ACTIVITIES AND EVENTS. TO PROMOTE THE EVENT, A SPECIAL AUDIO-VISUAL PROGRAM WAS DEVELOPED AND DISTRIBUTED WITH LITERATURE TO COMMERCIAL LIBRARIES OF U.S. EMBASSIES AND CONSULATES IN 21 COUNTRIES.

THIS CASE DEMONSTRATES HOW ITA PROGRAMS AND SERVICES HAVE BEEN SUCCESSFULLY USED BY AHMA TO LEAD ITS MEMBERS INTO WORLD MARKETS. AHMA'S ACTIVITIES HAVE MERITED IT CONSIDERATION FOR THE PRESIDENT'S "E" AWARD FOR EXCELLENCE IN EXPORTING.

COMMENTS ON S.539, THE TRADE, EMPLOYMENT, AND PRODUCTIVITY ACT OF 1987

I WOULD NOW LIKE TO COMMENT ON SOME PROVISIONS OF S.539, THE TRADE, EMPLOYMENT, AND PRODUCTIVITY ACT OF 1987, THAT BEAR ON THESE PROGRAMS.

- EXPORT PROMOTION DATA SYSTEM

  THE EXPORT PROMOTION DATA SYSTEM (EPDS) IS An EFFICIENT WAY OF SUPPLYING U.S. EXPORTERS, AS WELL AS GOVERNMENT, STATES AND OTHER USERS, WITH TIMELY AND ACCURATE INFORMATION ON OVERSEAS MARKETS. THE SYSTEM WOULD CONTAIN OR PROVIDE ACCESS TO INFORMATION ON INDUSTRIAL SECTORS AND FOREIGN MARKETS WHICH ARE OF GREATEST INTEREST TO U.S. BUSINESSES ENGAGED IN EXPORTING, AND TO STATE EXPORT PROMOTION AGENCIES. EPDS INFORMATION WOULD INCLUDE U.S. EXPORTS BY STATE OF ORIGIN, IMPORTS BY COUNTRY OF ORIGIN, SPECIFIC OVERSEAS BUSINESS OPPORTUNITIES, FOREIGN MARKET SIZE, DISTRIBUTION PRACTICES, TARIFFS, TRADE BARRIERS AND MUCH MORE. THIS INFORMATION WOULD BE DEVELOPED THROUGH ITA'S TRADE PROMOTION AND OVERSEAS FACILITATION ACTIVITIES, AUGMENTED BY SELECTED INFORMATION DRAWN FROM OTHER AVAILABLE GOVERNMENT DATA BASES. ACCESS WOULD BE ELECTRONIC, THROUGH THE DEPARTMENT OR DESIGNATED ORGANIZATIONS. AND, BY DESIGN, ALL OF THE INFORMATION WOULD BE FORMATTED TO FACILITATE USE BY U.S. BUSINESS.

  BECAUSE IT USES THE COMMERCIAL INFORMATION MANAGEMENT SYSTEM AS A FOUNDATION, THE EXPORT PROMOTION DATA SYSTEM CAN BE UP AND RUNNING DURING 1987, AND IMPLEMENTED WITHIN EXISTING ITA RESOURCES.

  THE ADMINISTRATION PROPOSAL DIFFERS FROM S.489 (BINGAMAN) AND S.259 (CHILES) IN THAT THE TYPE OF DATA TO BE INCLUDED IN EPDS WOULD BE EASILY COLLECTED FROM EXISTING SOURCES. MOREOVER, EPDS WOULD CONTAIN DATA THAT BUSINESS, PARTICULARLY EXPORTERS, HAVE FOUND TO BE ESPECIALLY USEFUL IN CONDUCTING INTERNATIONAL TRADE. WE VIEW S. 489 AND S.259 AS REQUIRING THE COLLECTION AND ANALYSIS OF VAST AMOUNTS OF INFORMATION -- SOME OF WHICH WOULD BE VERY DIFFICULT, IF NOT IMPOSSIBLE TO COMPILE -- AND NOT NECESSARILY MEETING THE

IMMEDIATE NEEDS OF U.S. EXPORTERS.

EXPORT TRADING COMPANIES

NOW I WOULD LIKE TO TURN MY REMARKS TO THE EXPORT TRADING COMPANY PROGRAM.

THE EXPORT TRADING COMPANY ACT OF 1982 SEEKS TO INCREASE U.S. EXPORTS IN THREE WAYS. IT ENCOURAGES MORE EFFICIENT PROVISION OF EXPORT TRADE SERVICES TO DOMESTIC PRODUCERS AND SUPPLIERS. IT IMPROVES THE AVAILABILITY OF TRADE FINANCE. AND, IT REMOVES ANTITRUST RISKS FOR EXPORT ACTIVITIES.

THE DEPARTMENT OF COMMERCE IS THE LEAD FEDERAL AGENCY RESPONSIBLE FOR IMPLEMENTING THE ACT, AND AS A RESULT THE DEPARTMENT'S OFFICE OF EXPORT TRADING COMPANY AFFAIRS WAS CREATED IN 1983. THAT OFFICE IS ACTIVELY ENGAGED IN PROMOTING THE FORMATION OF EXPORT TRADING COMPANIES, PROVIDING ADVICE AND COUNSEL, MAINTAINING A CONTACT FACILITATION SERVICE, AND PROCESSING APPLICATIONS FOR ANTITRUST PROTECTION UNDER THE EXPORT TRADE CERTIFICATE OF REVIEW PROGRAM.

THE FEDERAL RESERVE BOARD IS RESPONSIBLE FOR ADMINISTERING THAT PORTION OF TITLE II OF THE ACT THAT PERMITS BANK HOLDING COMPANIES AND CERTAIN OTHER ELIGIBLE FINANCIAL INSTITUTIONS TO OWN ALL OR ANY PART OF AN EXPORT TRADING COMPANY.

STATUS OF THE PROGRAM

AS OF MARCH 12, 1987, THE DEPARTMENT OF COMMERCE HAS ISSUED 71 CERTIFICATES OF REVIEW UNDER THE TITLE III ANTITRUST PRECLEARANCE PROGRAM. THESE CERTIFICATES PROVIDE ANTITRUST PROTECTION TO 307 FIRMS AND INDIVIDUALS. AS OF THE SAME DATE, 41 BANK HOLDING COMPANIES HAVE NOTIFIED THE FEDERAL RESERVE BOARD OF THEIR INTENTION TO MAKE EQUITY INVESTMENTS IN ETCS AS PROVIDED FOR IN TITLE II.

IN CARRYING OUT OUR TITLE I PROMOTIONAL RESPONSIBILITIES, COMMERCE HAS CONDUCTED A VIGOROUS OUT-REACH PROGRAM. OUR AIM IS TO INFORM THE BUSINESS, LEGAL, AND FINANCIAL COMMUNITIES ABOUT THE BENEFITS OF THE ACT. FOR EXAMPLE, THE ETC OFFICE AND U.S. AND FOREIGN COMMERCIAL SERVICE DISTRICT OFFICES THROUGHOUT THE COUNTRY ARE CURRENTLY CONDUCTING A SERIES OF NINE CONFERENCES THIS FISCAL YEAR. THIS IS JUST THE LATEST OF A SERIES OF OUTREACH ACTIVITIES CONDUCTED BY COMMERCE IN COOPERATION WITH OTHER GOVERNMENT AGENCIES AND PRIVATE SECTOR ORGANIZATIONS. WE HAVE MADE MANY ETC ACT PRESENTATIONS BEFORE TRADE GROUPS, AND PUBLIC SECTOR ORGANIZATIONS.

TITLE II - BANK EXPORT SERVICES ACT

WE HAVE SAID REPEATEDLY THAT THE REGULATIONS AND ADMINISTRATIVE PRACTICES ADOPTED BY THE FEDERAL RESERVE BOARD FOR THE TITLE II BANK ETC PROGRAM ARE TOO STRINGENT TO PERMIT BANK ETCS TO COMPETE EFFECTIVELY WITH THEIR FOREIGN COMPETITION. ON TWO OCCASIONS -- SEPTEMBER 21, 1983 AND SEPTEMBER 13, 1984 --

SECRETARY BALDRIGE WROTE CHAIRMAN VOLCKER REQUESTING THE BOARD'S COOPERATION IN MODIFYING ITS TITLE II REGULATIONS TO PROVIDE BROADER POWERS TO BANK ETCS.

IN DECEMBER 1985, THE INDUSTRY SECTOR ADVISORY COMMITTEE FOR SERVICES EXPRESSED STRONG SUPPORT FOR CHANGES IN THE BOARD'S REGULATIONS, AND SPECIFICALLY REQUESTED COMMERCE TO CONVEY ITS VIEWS TO THE FEDERAL RESERVE BOARD. INDUSTRY DISSATISFACTION WITH THE REGULATIONS IS ALSO DISCUSSED IN THE FEBRUARY 1986 REPORT OF THE U.S. GENERAL ACCOUNTING OFFICE ENTITLED "IMPLEMENTATION OF THE EXPORT TRADING COMPANY ACT OF 1982." COMMERCE AGREES WITH THE GENERAL CONCLUSIONS REACHED IN THAT COMPREHENSIVE STUDY.

IN ADDITION TO THE SECRETARY'S LETTERS AND MEETINGS WITH CHAIRMAN VOLCKER, COMMERCE ESTABLISHED A TASK FORCE TO WORK WITH THE BOARD'S STAFF IN AN EFFORT TO GIVE BANK ETCS GREATER OPERATING FLEXIBILITY. TO DATE, WE HAVE NOT SEEN A WILLINGNESS ON THE PART OF THE BOARD TO MAKE THE KIND OF CHANGES THAT BANK ETCS AND THE GENERAL ACCOUNTING OFFICE SAY ARE NEEDED IF THE ETC CONCEPT IS TO BE USEFUL TO BANKS.

DISAGREEMENT WITH THE BOARD'S REGULATIONS AND PRACTICES INVOLVES FIVE SPECIFIC AREAS: (1) LIMITATIONS ON WHAT A BANK ETC CAN DO; (2) THE METHOD FOR CALCULATING WHETHER A BANK ETC MEETS THE "50 PERCENT REVENUE TEST"; (3) LIMITS ON A BANK ETC'S ABILITY TO TAKE TITLE TO GOODS; (4) LIMITS ON FINANCIAL LEVERAGING; AND (5) COLLATERAL REQUIREMENTS FOR A LOAD TO AN ETC FROM ITS AFFILIATED BANK. WE ARE VERY PLEASED THAT THE AMENDMENTS PROPOSED BY SENATOR HEINZ IN S.653 ADDRESS ALL FIVE OF THESE SPECIFIC AREAS.

SECTION 202 OF THE EXPORT TRADING COMPANY ACT MAKES IT CLEAR THAT THE PURPOSE OF TITLE II IS TO PROVIDE FOR "MEANINGFUL AND EFFECTIVE PARTICIPATION BY BANK HOLDING COMPANIES, BANKERS' BANKS, AND EDGE ACT CORPORATIONS, IN THE FINANCING AND DEVELOPMENT OF EXPORT TRADING COMPANIES IN THE UNITED STATES." TO ACCOMPLISH THIS, CONGRESS SAID THAT THE FEDERAL RESERVE BOARD SHOULD ADOPT REGULATORY POLICIES THAT WOULD GIVE EXPORT TRADING COMPANIES SUFFICIENT POWERS TO ENABLE THEM TO COMPETE WITH SIMILAR FOREIGN-OWNED INSTITUTIONS. OUR BANK ETCS DO NOT CURRENTLY HAVE THOSE POWERS.

THE CURRENT REGULATORY ENVIRONMENT IMPOSED BY THE BOARD IS INHIBITING BANK ETCS FROM DEVELOPING INTO EFFECTIVE COMPETITORS. REPRESENTATIVES OF BANK ETCS HAVE TESTIFIED TO THIS EFFECT SEVERAL TIMES, AND A NUMBER OF TRADE GROUPS HAVE ASKED FOR RELIEF. IN SHORT, LEGISLATION IS NEEDED.

FOR THIS REASON THE ADMINISTRATION'S TRADE, EMPLOYMENT AND PRODUCTIVITY BILL INTRODUCED IN THE SENATE ON FEBRUARY 19 INCLUDES AMENDMENTS TO TITLE II WHICH GIVE BANK AFFILIATED ETCS GREATER OPERATING FLEXIBILITY. OUR PROPOSAL WOULD:

- AMEND THE DEFINITION OF A BANK ETC TO (1) INCLUDE REVENUES DERIVED FROM THIRD-COUNTRY TRADE AS EXPORT

RELATED REVENUE; AND (2) PERMIT A BANK ETC TO EXPORT ITS OWN SERVICES;

- REMOVE THE $2 MILLION LIMITATION ON THE AMOUNT OF INVENTORY THAT CAN BE HELD BY A BANK ETC;
- LIBERALIZE THE DEBT-TO-CAPITAL RATIO LIMITATIONS; AND
- EXEMPT BANK ETCS FROM HAVING TO MEET THE STRINGENT COLLATERAL REQUIREMENTS FOR LOANS FROM THEIR AFFILIATED BANKS REQUIRED BY SECTION 23A OF THE BANK HOLDING COMPANY ACT.

THESE CHANGES ARE QUITE SIMILAR TO THE PROVISIONS OF S.653. I KNOW, SENATOR HEINZ, THAT YOU HAVE TAKEN GREAT INTEREST IN THE ETC ACT, AND ORIGINALLY PROPOSED THESE AMENDMENTS BACK IN DECEMBER OF 1985.

I AM CONFIDENT THAT THE MINOR DIFFERENCES IN TITLE II PROVISIONS OF OUR TWO BILLS CAN BE WORKED OUT, AND WE WILL BE ABLE TO MOVE FORWARD WITH THIS IMPORTANT LEGISLATION.

TITLE III - EXPORT TRADE CERTIFICATES OF REVIEW

THOUGH WE ARE PLEASED WITH THE PROGRESS OF THE TITLE III CERTIFICATE OF REVIEW PROGRAM, WE BELIEVE THERE ARE AREAS WHERE IT CAN BE STRENGTHENED. FOR THIS REASON, WE HAVE PROPOSED AMENDMENTS TO CLARIFY THE EXISTING PROVISIONS OF TITLE III. THE AIM IS TO PROVIDE GREATER CERTAINTY REGARDING THE ANTITRUST PROTECTION AFFORDED BY AN EXPORT TRADE CERTIFICATE OF REVIEW.

THE MOST IMPORTANT OF THESE WOULD UNIFY THE CURRENT FOUR STANDARDS FOR CERTIFICATION INTO ONE CONCISE STANDARD, CLARIFY THE PROPER STANDARD AND SCOPE OF JUDICIAL REVIEW, REINFORCE THE STATUTORY BASIS FOR EXTENDING PROTECTION TO APPLICANT"S MEMBERS, AND MAKE SURE THAT "EXPORT TRADE COVERS FEDERALLY FINANCED TRANSACTIONS.

WE ARE PLEASED TO FIND THAT S.653, INTRODUCED BY SENATOR HEINZ, INCLUDES THE CHANGES TO TITLE III THAT WE HAVE PROPOSED.

I APPRECIATE HAVING THE OPPORTUNITY TO TALK WITH YOU TODAY, AND WELCOME YOUR QUESTIONS AND COMMENTS.

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Statement by

Manuel H. Johnson, Jr.

Vice Chairman

Board of Governors of the Federal Reserve System

before the

Subcommittee on International Finance and Monetary Policy

of the

Committee on Banking, Housing, and Urban Affairs

United States Senate

March 25, 1987

I am pleased to appear before you today to discuss the topic of bank-affiliated export trading companies.

In its consideration of the export trading company legislation in 1982, the Congress determined that U. S. export performance was inhibited by the inability of U. S. businesses, especially small- and medium-sized companies, to develop foreign markets for their products due to their lack of expertise in the mechanics of exporting. The Congress therefore sought to promote the establishment of companies that could supply the necessary expertise in order to assist U.S. companies in increasing exports of their goods and services. In enacting the Bank Export Services Act ("BESA"), the Congress decided that one method by which export trading companies could be developed was by permitting affiliations with banks through a bank holding company structure.

Now that we have had some experience with the operation of bank-affiliated export trading companies under the legislation, we thought it would be useful to share information on that experience with you in connection with the Committee's consideration of further refinements to the export trading company concept. While a beginning has been made in the

development of export trading companies as promoters of U.S. exports, unfavorable economic conditions have not provided an atmosphere in which export trading companies can flourish.

Since the passage of the legislation in October 1982, the Federal Reserve has acted upon 43 notifications by bank holding companies to establish export trading companies. Sixteen of these have been acted upon by the Reserve Banks under authority delegated to them by the Board in 1983. This number represents more than 50 percent of the notifications processed since the delegation rules were adopted.

The Board recently conducted a survey of nine bank-affiliated export trading companies, selected to provide diversity of size and geographic location of the bank holding company parent. For those export trading companies responsive to the survey, the assets size ranged from $210,000 to $21 million, with the average being $8.2 million, and gross revenues ranged from $110 thousand to $18 million, with the average also being $8.2 million.

The activities of these export trading companies were also quite diverse. Several were engaged almost exclusively in transactions involving the purchase and sale of goods, while the others received their income largely from fee-based services. The services included transportation; marketing and consulting; acting as an agent for a Foreign Sales Corporation; and trade financing services. The survey suggests that bank-affiliated export trading companies are able to offer a broad range of services under the current statute and regulations and a number appear to be operating profitably.

While results suggest some bank-affiliated export trading companies are operating successfully, others have experienced some difficulties. Of the 43 bank-affiliated export trading companies of which the Board received notice, 14 are no longer operational. In a few instances, the cessation of export trading company activity was related to changes in the ownership of the export trading company, such as through acquisitions and mergers. However, this performance has been largely related to the difficulties that bank holding companies have experienced in operating an export trading company. In addition to poor economic conditions in their first years of existence, described below, which resulted in diminished profit potential, these export trading companies have also encountered start-up difficulties resulting from unfamiliarity with the trading business. Other problems encountered are peculiar to the activities of trading companies, regardless of how long they have been operating: for example, a customer breaking the terms of its own trade agreement, or the inability of an export trading company to deliver on a major contract, or inadequate controls over the trading activities.

To the extent that the performance of bank-affiliated export trading companies has been disappointing, it should be noted that there is no evidence that trading companies without bank affiliation have been any more successful. While there is no comprehensive means of tracking the performance of all these trading companies, the General Accounting Office, in the course of preparing its February 1986 Report to Congress on the Implementation of the Export Trading Company Act of 1982, conducted a survey of 23 trading organizations that had obtained certificates of review from the Department of Commerce. Many of those firms reported that business was disappointing, citing economic factors, particularly the high value of the dollar, as the reason.

Although the experience of bank-affiliated export trading companies to date has fallen short of expectations, this is due primarily to the highly unfavorable economic climate for U.S. exports that resulted from the overvalued exchange rate for the U.S. dollar, the lack of adequate economic growth in foreign industrial countries, and the need for adjustment in many developing countries. Therefore, the period since 1982 has clearly not been a fair test of the viability of bank-affiliated export trading companies on which far-reaching changes in the law should be based. In addition to the macro-economic conditions faced by export trading companies, there are other factors contributing to their slow development. It is still a fledgling industry; the oldest of the bank-affiliated export trading companies is not yet four years old. Moreover, a review of several articles concerning bank-affiliated export trading companies in recent years indicates that the affiliation of two such different corporate cultures as banking and trading inevitably creates difficulties in forging a viable and profitable enterprise. I might add that the publications generally do not attribute the lack of success of export trading companies to the Board's regulations, but rather to the various economic and business factors that I have mentioned.

In efforts to make refinements to the legislation governing the operations of bank-affiliated export trading companies, which we all see as a desirable effort, it should be remembered that banking organizations were perceived as providing two essential elements for a successful export trading company -- a source of capital and financing and a network of foreign offices able to evaluate foreign markets and provide necessary foreign contacts. The legislation therefore created a very limited exception to the statutory separation of banking and commerce in order to achieve the goal of improving the export sector of the economy. The BESA was not, as we read it, intended to let bank holding companies perform every type of international activity nor to relax to any great extent the provisions protecting bank safety and soundness. Bank-affiliated export trading companies were intended to assist other companies in the export of their goods and

services and not to compete with these companies by becoming themselves producers of services for export. Moreover, the Act recognizes that there are activities from which export trading companies should be explicitly excluded, such as securities activities, agriculture, dealing in commodities, and manufacturing. The Act contains these and other important safeguards that are intended to maintain the separation of banking and commerce and to avoid compromising significant supervisory goals. These measures were adopted in recognition that one goal of national importance -- export promotion -- should not be achieved at the expense of another -- a safe and sound banking system.

The Board's regulations implementing the BESA are designed to carry out the statute's intent. Because the statute did not focus on promoting trade, but on promoting U.S. exports through export trading companies, our regulations are designed to ensure that such companies engage in trade services that promote U.S. exports. As a result, the Board's regulation requires that 50 percent of a bank-affiliated export trading company's business must derive from exporting or facilitating the export of goods and services produced in the United States by persons other than the export trading company and its subsidiaries. Under this test, a bank-affiliated export trading company may provide services to any party, foreign or domestic, that is connected to an international trade transaction, as long as the majority of the company's business is export-related.

Let me at this point clear up some confusion over one aspect of the 50 percent revenues test in the Board's regulations. A bank-affiliated export trading company may provide services not only to unaffiliated persons, it can also help to promote the goods and services of any of its affiliates; that activity is considered as facilitating a U.S. export under the regulation. For example, an export trading company could market abroad computer software developed by its bank holding company parent; revenues derived from that activity are considered export revenues. Thus, contrary to the perception of some, a bank-affiliated export trading company is authorized to assist its affiliates in exporting services.

As I have mentioned, one of the fundamental premises of the legislation is that bank-affiliated export trading companies will facilitate the export of goods and services of other U.S. companies and will not engage directly in such activities themselves. Accordingly, the Board's regulations, consistent with the purposes of the BESA, prevent a bank holding company, under the guise of an export trading company, from acting only as a service company for foreigners, that is, from engaging in a service activity, which might not be even a trade service, that is provided only to foreign parties. An example would be an insurance company that underwrites and sells property and casualty insurance policies to foreign customers.

This situation, in which a bank holding company becomes the producer of the service to be exported, would be inconsistent with an export trading company's role as a facilitator of exports. The regulations, however, permit formation of a joint venture with an insurance company to facilitate the sale of the insurance company's policies abroad. Therefore, there is a broad scope in the statute and the regulation for a bank-affiliated export trading company to provide services in support of exports.

Some of the legislative proposals have implicitly taken issue with the Board's regulation requiring that 50 percent of an export trading company's business derive from exports or facilitating exports produced by others. This is also the area of current regulation where the most flexibility is sought by the surveyed bank-affiliated export trading companies, i.e., in the application of the 50 percent of revenues test.

These legislative proposals would alter the original intent of the statute in a fundamental way. The original bill was intended to promote exports and build an export-oriented infrastructure of trading companies. Some of the proposed legislation would not seem to further those goals.

First, these proposals would permit an export trading company to count as export revenues any revenues derived from third country trade. The rationale is that the export trading company itself is providing a service and that the third country trade activity does not hurt U.S. trade balances because it does not involve an import. Our view is that such proposals sanction the development of bank-affiliated trading companies that need not facilitate the export of any product produced in the United States at all. They would permit a trading company to set up foreign companies to provide a broad range of services to foreign parties without any benefit either to U.S. jobs or toward developing an export trading industry that can serve companies that actually produce goods and services in the United States. This approach would create a movement in the opposite direction from providing export trade services to those U.S. companies that need assistance in exporting.

Moreover, it is not readily apparent that, as many claim, third country trade would not harm U.S. trade. If a foreign country is buying computers from Germany, it is not buying them from the United States. Third country trade therefore can hurt U.S. exports, as many third country transactions are substitutions for U.S. exports.

In addition, by permitting bank holding companies to invest in any company, regardless of its business, as long as it offers its services exclusively to foreign customers, the proposed legislation would put bank holding companies into direct competition with other U.S. companies that are intended to be the primary beneficiaries of the original act, i.e., companies that produce goods and services in the United States

which with the help of an export trading company could be exported. Such a result seems perverse in two ways. First, it reduces any incentive on the part of bank-affiliated export trading companies to market their trade services to U.S. companies. Under the proposals, if a bank holding company were to identify potential projects or markets abroad, it could establish a trading company to take on the project or service, rather than approach U.S. companies either to form a joint venture to take advantage of the opportunity or to otherwise assist the U.S. company in exporting its service.

Second, the proposals would expand the kinds of activities in which a bank holding company may engage indirectly through an export trading company. There is already a statutory and regulatory framework for the expansion of the operations of bank holding companies and Edge corporations outside the United States that provides considerable flexibility in both activities and investments. For example, in some instances, U.S. banking organizations have been permitted to establish foreign companies that underwrite and sell life insurance. This has been done, however, under statutes that allow the Federal Reserve to consider fully the effect on banks and the banking system, taking into account factors not applicable to the BESA. A radical change in the authority to conduct activities overseas, such as the proposals would provide, should be dealt with straightforwardly as a question of new products and services for banking organizations. The Board strongly supports authorization of some new products and services for bank holding companies but believes that they should be granted in a direct fashion, and not through trade legislation, especially where there would be no benefit to U.S. exports generally.

Although these proposals would shift the emphasis of the original statute from export promotion to promotion of international trade *per se* by permitting bank holding companies to engage in general trading activities without regard to promoting U.S. exports, this is of course a matter for Congress to decide. The Board's regulations requiring a predominance of exports are, however, fully consistent with the intent of Congress at the time of passage of the BESA.

With respect to the ability of a bank to finance its affiliated export trading company, the BESA subjects a bank's extension of credit to an affiliated export trading company to the provisions of section 23A. As you know, section 23A requires collateralization for any extension of credit by a bank to an affiliate, usually in an amount that exceeds the face amount of the extension of credit. This is entirely appropriate in order to protect the bank. However, in recognition of the need for a bank-affiliated export trading company to secure funding for its trading in goods, the Board has provided a reasonable exception by waiving the excess collateral requirement for loans by a bank to its affiliated

export trading company. The regulations require instead that the bank take a security interest in goods or the proceeds from the sale of goods that are subject to a contract of sale. This measure enables an export trading company to obtain financing for the activity for which financing is most needed but the exception does not subject the bank to undue risk.

This liberalization of section 23A's collateral requirements is the type of carefully crafted exception to the provisions of section 23A that we believe is most appropriate in this context. It is tailored to the needs of an export trading company but ensures that the assets of the bank will not be jeopardized.

The Board also expects a bank-affiliated export trading company to be capitalized adequately to support its operations. There is no regulatory requirement, however, for a certain capital level. Each case is evaluated based on its own facts.

Some of the proposed amendments to the BESA that relate to section 23A and to capital requirements raise substantial supervisory concerns. The proposals would expand the ability of a bank-affiliated export trading company to take on the equity risk of foreign subsidiaries, clearly increasing the risk to which the export trading company is subject. At the same time, the proposals would reduce the safeguards for the affiliated bank, by exempting all transactions from the collateral requirements of section 23A and by permitting an export trading company to be less than adequately capitalized.

These changes would seem to be especially inappropriate at this time when there is a consensus that bank affiliates should be subject to market discipline. An affiliate should not be able to use a bank's resources -- and the federal guarantee for those resources -- except to the extent permitted by the provisions of section 23A. As the Board has consistently stated, if a bank-affiliated export trading company is creditworthy, it can obtain credit in the market even from a non-affiliate. If an export trading company is not creditworthy, an affiliated bank should not be placed at risk by being able to lend without collateral. Moreover, a total elimination of section 23A collateral requirements is directly contrary to the approach taken in other recent legislative proposals, which would actually strengthen the protection available to the bank.

As I have previously stated, the Board has been willing to be flexible in its approach to section 23A as it applies to loans to bank-affiliated export trading companies but only where the bank will not be adversely affected. We cannot support any proposal that would permit a nonbank affiliate to drain the resources of the bank in pursuit of its business.

With respect to capitalization, some of the legislative proposals would permit an export trading company to operate with a capital to assets ratio of 4 percent. That ratio would be low for most trading companies; such ratios are

Senator SARBANES. Thank you very much.
Mr. Bohn.

STATEMENT OF JOHN BOHN, PRESIDENT, EXPORT-IMPORT BANK

Mr. BOHN. Thank you, Mr. Chairman.

What I would like to do is to outline briefly the basis of and some of the parts of our new programs and leave most of the time for questions.

TASK FORCE ORGANIZED

As you will recall, last year was the year when the extension of the life of the Export-Import Bank was up, and, as you all know, we were given another 6 years. In that process, a number of issues were raised, not only by the legislation but as a result of our own task force inquiry, as to how we could do things differently.

We put together a task force to look at the marketplace, and the conclusions were, I think, very important to us and provide a background necessary to understand some of the program modifications we have made really in the last 2 or 3 months.

The first issue that was raised was whether or not our market had changed. We were not seeing the large megabuck projects that we had seen in the 1970's. Much more of the business we were seeing was in discrete products and services.

Second, we determined that the traditional sources of financing for export, namely, the commercial banks, were moving away from financing the traditional exporters.

There are perfectly sound reasons for that, Mr. Chairman. Some of course relate to the debt situation. Some relate to the increased competitiveness within the banking system. But the net of it was that on the one hand the banks were becoming more and more interested in the large, low labor cost kinds of transactions while the exporting community was facing a market which demanded a longer time to put projects together, a greater degree of analysis, and indeed the ability to absorb more risk.

We found, in short, that the banks were moving in one direction with respect to exports while the exporters' needs were moving in another.

The third was that if we were going to begin to move America into an exporting or international mode it was necessary for us to focus on the medium-sized and smaller exporter. The larger exporters certainly know the programs and are highly skilled in the export business, but if we are going to make a real impact, we have to focus on the middle market area.

We also found that, again, for the middle-sized exporter many of our programs seemed too complex. The procedures were too convoluted and, simply, they were therefore almost inaccessible. We therefore concentrated on dealing with this problem of accessibility to the Export-Import Bank and our insurance programs.

TAKING A GOOD LOOK AT THE BANKING SYSTEM

We took a good look at the banking system. We took a good look at a number of intermediaries, and our programs that I will outline for you shortly really are based on trying to get the banks back

into supporting exports, and so to provide accessibility to the medium-sized company outside of Washington; second, to utilize new and different kinds of intermediaries. We have then gone out and looked at States, we have looked at trade organizations and the rest.

So what we have done then is designed to facilitate access to the Bank, not only directly as the legislation provides, but frankly, Mr. Chairman, more importantly through knowledgeable intermediaries that have the skills and the ability to deal with and help an exporter in the somewhat perilous and uncertain business of exporting.

A good example, Mr. Chairman, comes in your own State, where the Ellicott Machine Corp. received some support from us in meeting a mixed credit assault from a German company. Our contribution to that was to simply level the playing field so that the quality of the product and the price permitted it to win over the German competitor. What is important about it is that there was also cooperation from the State of Maryland in the form of, as I understand it, a training grant, which also contributed toward the company winning the sale.

It is that kind of cooperation, Mr. Chairman, that some of our programs are designed to deal with. We have had very good cooperation from the United States and Foreign Commercial Service, both here and overseas.

We run, as you know, a series of training programs every month for 4 days. We have had a number of Mr. Good's people in, both from offshore and domestically, learning our programs, being familiar with our procedures, and we try—before the ones who go offshore do go—to bring them in to familiarize them with the programs.

A number of us on our travels try to coordinate with seminars that they are holding overseas. A number of us go and visit the various States and the various cities where their offices are located, and they will organize programs around the Exim program.

It is that kind of cooperation and intermediation that we think provides the best hope for really getting a broad-scale exporting program.

In summary, what we have tried to do is to provide essentially one loan and guarantee program with access both by banks and nonbanks. We now provide 85 percent financing.

ON-AGAIN, OFF-AGAIN POLICY

One of the complaints we had heard over the years was that we at least appeared to have an off-again, on-again policy in a number of countries. So just 2 weeks ago we announced that we are going to a country-differentiated fee structure; that is to say, that the fees that will be charged to the exporters will relate to risk that we perceive in the transaction. The purpose of that is to permit us over time to break even, but it will also permit us, more importantly, to stay open in a number of countries where otherwise we simply would be closed.

We don't know how well that is going to work yet, but our belief is and our intention is to provide exporters much longer lead times so they can plan and continue to compete.

We are also trying our very best to provide a realistic transferability for a number of our instruments and our guarantees. The reason for that, again, is to try to get into the capital markets which seem very much to have taken the lead in innovative kinds of financing. We would like to harness the capital markets through the use of our guarantee into the support of the exporting community.

Indeed, when we had our Bankers' Conference a few weeks ago, there seemed to be a good deal of interest in the commercial banking community and in the investment banking community in working with us to design a kind of security which would permit the banks, once they had made an export loan, to in turn resell that into the market.

This provides the banks with another important facility and an ability to manage their liquidity, as well as simply making an export loan. We think this will go a long way toward attracting the banks back into the program.

There are a number of other minor things. We have regularized our payment procedure, again to facilitate access to the capital markets.

We have quantified and developed a formula for quantifying interest and principal coverage upfront in advance, so that in fact the buyer of these securities will know what they are at risk for.

IMPROVEMENTS IN SMALL BUSINESS PROGRAM

And we just recently made some improvements in our small business program, again, as a result of the task force study in the area of collateral, in the area of parity of liens.

We are working on a delegated authority program, which we hope we will be able to come down within the next 90 days and by which we hope to give the banks themselves and the various communities the ability to commit on our behalf—again for this middle-sized market.

On the mixed credit front, Mr. Chairman, I am pleased that we have what looks like an agreement. I, too, would have preferred to have a 50-percent grant number, but the phasing-in, I think, will necessitate us continuing to keep a vigilant eye on what is going on. I would suspect that over the next 18 months, when this is going to be phased in, we will be faced with a series of grandfathered cases from some of our trading partners, and I hope that we will be able to make sure that we can meet those kinds of predacious practices, which I suspect will continue until the final agreement gets set.

I think it is important to emphasize that because, as you know, the President has requested another $200 million for the war chest in fiscal 1988. I think we will need that.

My hope is and my expectation is that once that agreement is in place we will not have to go through the war chest exercise again.

Mr. Chairman, I think that summarizes the general parts of the programs. I will be happy to answer any specific questions you might have.

[The complete prepared statement of John A. Bohn, Jr. follows:]

typically at least 25 percent for trading companies not affiliated with banks. The proposed ratio is even lower than the capital required of a bank. We see no justification for reducing the Board's ability to require that a bank holding company subsidiary be adequately capitalized in relation to its business. Having said this, it should be noted that where the proposed activities of a bank-affiliated export trading company have risk characteristics similar to those of a bank, the Board has determined that the export trading company may maintain a capital ratio equivalent to that required of a bank.

Such a proposal permitting a low capital to assets ratio would also be contrary to prudent supervisory policies as reflected in recent efforts, including those of the Congress in passing the International Lending Supervision Act of 1983, to increase capital of banking organizations involved in international activities. Moreover, it would remove bank-affiliated export trading companies from the market restrictions imposed on other companies not affiliated with banks, thereby encouraging increased risk-taking with its concomitant risk to the banking organization. It should be kept in mind that a bank can be harmed not only by direct interaction with an affiliate but also by a weakening of the bank holding company's ability to serve as a source of strength to its subsidiary banks.

In addition to the supervisory questions raised by these proposals on section 23A and capital adequacy, the proposals raise a serious issue of competitive equity. These proposals place bank-affiliated export trading companies in a favored position over all other competitors by removing them from the effects of market discipline. A bank-affiliated export trading company would have a ready source of financing, even if the company is not creditworthy, and could undertake a higher volume of activities because of its low capitalization. This situation would be entirely inconsistent with the concept of a level playing field.

In light of these factors, the Board must oppose any proposals that would increase the risk to the bank from the operation of the affiliated export trading company. Such export trading companies should be permitted to operate with sufficient flexibility to allow them to succeed but within appropriate constraints on their ability to harm their affiliated banks. We believe that the current statutory and regulatory framework achieves these goals. The recent past did not provide circumstances for the best test of the current framework. Changing economic conditions should make it easier for these export trading companies to operate more successfully in the next few years.

While we believe that the foregoing is a realistic assessment of both the current law and the proposals that have been introduced into the Congress, the Federal Reserve is, as always, willing to work with the Congress in developing

necessary legislative reforms. We urge you, however, to keep in mind that some of the proposals raise serious supervisory concerns. Others are aimed at changing the purposes of bank-affiliated export trading companies from an export orientation to encouraging trade outside the United States or even U.S. imports. In the final analysis, of course, the goals for any new legislation are established by the Congress, and the Board always endeavors to adopt implementing regulations that reflect those goals.

Thank you very much.

STATEMENT OF
THE HONORABLE JOHN A. BOHN, JR.
PRESIDENT AND CHAIRMAN
EXPORT-IMPORT BANK OF THE UNITED STATES
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

March 25, 1987

Mr. Chairman, Members of the Subcommittee:

Thank you for inviting me to testify before the Subcommittee to review with you the activities of the Bank over the past year, particularly the changes and improvements in our programs since enactment of the Eximbank legislation in 1986. I look forward to working with Senator Sarbanes as the new Chairman of this Subcommittee, as well as to continuing the Bank's relationship with Senator Heinz and others on the Subcommittee who have been so knowledgeable and helpful to us in the past.

In view of these changes in the Subcommittee, I think it is only fair that we have brought you a new Eximbank. While we've been around for more than fifty years, the events of the last year -- both in Congress and at the Bank -- are resulting in the most significant overhaul of our programs since 1960. Our hope and goal is that they will make a major difference in the way U.S. suppliers do business with Eximbank and, more importantly, in the way in which they do business overseas.

I would like to review with you today the full range of the Bank's activities and the most recent major legislative directives that Congress provided last year when it passed the Export-Import Bank Act Amendments of 1986 and extended our charter for six years until September 30, 1992. Incidentally, that Act was the only piece of trade legislation enacted last year.

This is what Congress told us to do in 1986 --

-- Improve our medium-term programs so that they are more competitive and less burdensome, attract the widest possible participation of private capital and are as supportive of exports as our long-term programs;

-- Make available medium-term risk protection coverage for creditworthy trade associations, export trading companies, export finance cooperatives, and other multiple-exporter organizations;

-- Provide access under all of our programs to nonbanks as well as banks;

-- Permit the unrestricted transferability of obligations guaranteed or insured by us without affecting coverage;

-- Weigh more closely the domestic economic consequences of transactions authorized by us;

-- Establish a tied aid credit program to facilitate the negotiation of international agreements to restrict the use of such credits for commercial purposes.

I'm glad to be able to say to you today that we have already done many of the things you've asked us to do and will finish the rest as soon as we complete the revision of our programs.

At the same time, let me emphasize that in responding to Congressional directives, we want to implement them in a way that will enable us to complete our mission effectively. That mission, you will recall, is to help American exporters meet government-supported competition from other countries and to correct market imperfections so that financing will be available to assist U.S. suppliers in making sales overseas, especially to assume risks in the support of exports which the private sector cannot reasonably be expected to take.

Even before the Eximbank amendments were enacted on October 15, 1986, we realized that the international economic situation had changed dramatically in many ways and that our programs needed to be modified to meet these changes. In the 1970's Eximbank funded enormous projects in dozens of countries -- infrastructure in Brazil and Mexico, mining and natural resource utilization in Asia and expansion of manufacturing production throughout the world. We also supported the sale of nuclear and conventional power plants as well as numerous aircraft. In short, we caused a lot of exports to go forward and provided a lot of jobs in the U.S. economy.

Everything changed by the early 1980's. We still see some large projects, but small projects, shelf items or

individual items of equipment, and services constitute an increasingly large portion of our business. Moreover, commercial banks have largely withdrawn from financing exports, shutting out American exporters from already shrinking less developed country markets. Deregulation and increasing competition have focused their attention on bottom line results, and high overhead export finance has been less profitable than other banking services. Trade finance departments have simply been eliminated, because commercial banks have little appetite for country risk. In short, exporters and lenders -- American lenders at any rate -- have been heading in opposite directions. Exporters need financing in riskier markets and on deals which are smaller and take longer to put together and close. Lenders, in contrast, want less risk, higher profit, transaction-oriented and less labor-intensive activities.

On the whole, foreign governments provide less subsidy for export credit than five years ago. Still, subsidized financing is a continuing problem in industries and in certain markets. Tied aid credits are the prime example of continuing pernicious practices.

When we reviewed Eximbank's programs, we discovered that many exporters and lenders consider them too cumbersome to be useful, too complex to be understandable and too uncertain of application to be appealing. They talked to us and to Congress about their problems. So, taking your directives and the results of our own analyses, we are coming up with new programs that will --

-- Enable us to assume a broader range of explicitly defined country and transaction risks;

-- Simplify, streamline and make internally consistent programs and procedures; and

-- Make programs accessible to the widest variety of potential sources of export finance, including capital market participants.

Let me turn to specifics. Since late last year, we have made available medium-term insurance policies to cover the members of trade associations, export trading companies, export finance cooperatives and other multiple-exporter organizations. We will also continue our search for new, effective intermediaries and look for ways of cooperating with State export assistance programs.

You told us to increase the competitiveness of our medium-term programs. We have now decided that with minor variations we will have essentially one loan program and one guarantee program for both medium- and long-term export transactions. Both programs will operate on the basis of preliminary commitments, and to implement our directive to provide access to both non-banks and banks, they will be open to any responsible party. Both programs will provide up to 85% financing, the maximum permitted under the OECD consensus. Eximbank loans will carry the minimum interest rate allowed by the OECD rate schedule for the market and the term.

We will charge a country/buyer/term differentiated risk fee on all transactions. Eximbank's fees will be comparable for both programs and will be competitive with those charged by other export credit agencies. They will be payable up front and may be financed. Such a fee structure is indispensable to a responsible increase in risk absorption; it also facilitates access to capital markets and provides for program consistency.

Since the 1986 amendments went into effect, all obligations guaranteed by us have been freely transferable. To facilitate transferability, we will allow lenders to charge prepayment penalties. Eximbank's guarantee of private lenders will be as close to unconditional as we can make it and will be issued following the approval of certain documentation. We will pay claims as promptly as possible and ensure that lenders continue to receive payments according to the original maturity schedule. We are still considering how best to keep track of, and retain responsibility for, our guarantees while facilitating their movement in capital markets.

We will also establish up front exactly how much interest and principal are to be covered. While the actual formulas will be announced later this month, let me say now that we are seeking to assume as much risk -- for an appropriate price -- as we can, to balance the needs of risk-averse financiers and prudent credit policy.

We also intend to absorb country risk in a way that will be clear, consistent and helpful. At the same time we will try to encourage the private sector to begin to take risks again. We will clarify our position with respect to operations in individual countries. Our intent is to stay open wherever possible by charging fees commensurate with assessed risk. We are still reviewing possible country classification schedules and proposed fees, as well as

Senator SARBANES. Thank you very much.

In view of the number of members here, I think we will follow the 5-minute rule and then go another round.

Senator Proxmire.

SERIOUS ISSUE OF COMPETITIVE EQUITY

Senator PROXMIRE. Mr. Good, Manuel Johnson, the man on your left—I should say Vice Chairman Manuel Johnson of the Fed—on pages 14 and 15 of his testimony says that the administration's proposals on section 23A and capital adequacy—and I quote now—

> Raise a serious issue of competitive equity. These proposals place bank-affiliated export trading companies in a favored position over all other competitors by removing them from the effects of market discipline. A bank-affiliated export trading company would have a ready source of financing even if the company is not creditworthy and could undertake a higher volume of activities because of low capitalization. This situation would be entirely inconsistent with the concept of a level playing field.

Do you agree that these points are valid and, if not, why not?

Mr. GOOD. Mr. Chairman, at the risk of being accused of being cowardly here, Mr. Luft, our Deputy Assistant Secretary, has the most hands-on knowledge on these issues, and I think he is probably the best witness to address that specific issue.

Senator PROXMIRE. Mr. Luft.

Mr. LUFT. Thank you, Senator Proxmire.

I disagree with the Vice Chairman's view on this matter, as does the Department of Commerce. There are other safeguards in the present framework that state that the lending relationship between the bank and the holding company and the bank-affiliated ETC has to be basically on terms that are equivalent to third party transactions.

The collateralization requirement we believe imposes an unnecessary burden because certainly the nonbank-affiliated ETC's do not have to contend with such a 100-percent collateralization requirement.

In addition, if we look at the question of the level playing field, it was the intent of this act to allow the United States to compete more effectively with its foreign competition.

I would stress that there is no such requirement for the most successful foreign trading companies; namely, the Shogoshosha, nor is there, to my knowledge, such a requirement in other countries.

I would like to cite as a very classic example of the nonexistence of such a requirement the case of the Michaelgesellschaft in Germany, which is a trading company but also holds a full banking license.

Senator PROXMIRE. Governor Johnson, would you like to respond to that?

Mr. JOHNSON. First, I think there is an important issue associated with nonbank affiliates of bank holding companies that doesn't necessarily apply to nonbank-affiliated organizations.

SPECIAL FEATURES OF BANKING ORGANIZATIONS

I think we all realize the special features of banking organizations from the fact that they have a specific charge to protect depositors' funds and to undertake prudent investments, and we have

to be very careful within a bank holding company structure that the use of insured deposits is not put to risk. Because there is not necessarily an arm's-length credit assessment that goes on with affiliated organizations in a bank holding company, you have to have specific rules on the flow of funds from a bank to its affiliated organizations. Because there isn't always this arm's-length credit assessment, I think that is why you have to have specific rules for affiliated organizations.

Now, in terms of the Japanese, I think the Japanese have significantly more restrictive investment requirements in nonbank-affiliated organizations and export trading companies. I think they have a 5-percent rule, and ours is certainly not that stringent, but we do require 100 percent collateralization of loans from banks to their nonbank-affiliated organizations. That is very important to make sure that there isn't excessive credit extension with no ability to recover that loan whereas if it was an arm's-length transaction outside the holding company organization you could always be confident that there was a separate credit assessment going on. That is not always the case with a bank holding company organization.

So I think that is why we feel very strongly about the section 23A rules.

Senator PROXMIRE. Governor Johnson, let me follow up with a reference to your testimony last June. Last June, when you testified on the proposed export trading company legislation, I asked you this question, and I am quoting now.

> Isn't it true that since the equity investment of a bank and an ETC can be 5 percent of the bank's capital, if you multiply that by 25 to 1 leverage it means that the bank is up to 125 percent of its capital, since the market expects it to stand behind the debt of the ETC. So if the ETC fails completely, down goes the bank.

I asked,

> Isn't that right?

You responded, and I quote:

> If it were leveraged to that degree and it failed, yes, it would more than likely cause the bank to fail.

Do you still stand by that response, or would you care to modify or expand on your previous answer in any way?

Mr. JOHNSON. I still stand on that response. I think that those types of possibilities could put the bank at significant risk. Being able to leverage to the degree that you suggest, on top of the fact that there may be unlimited lending availability from banks to their nonbank affiliates, could easily allow borrowing from an affiliated bank and the leveraging of those funds to the point where, relative to its capital, the bank is at risk.

We do have some examples of situations like that taking place. We have not yet had a situation where a bank has actually failed as a result of a failed export trading company that has violated section 23A rules.

But we have had an instance where an export trading company, due to a nonarm's-length transaction with an affiliated bank, has not provided collateral and has failed to deliver and has caused a default on the loan, which has put the bank at risk.

This particular example is not one where the bank failed, but it has significantly weakened the bank.

Senator PROXMIRE. Thank you very much.

Mr. JOHNSON. Thank you, Mr. Chairman.

Senator SARBANES. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you. I'd like to get into two issues, I guess principally with Mr. Johnson.

THIRD COUNTRY TRADE

One is the accounting that we do to satisfy the principally engaged-in-exporting test regarding third country trade as proposed under the administration and my bill. It's just not to be counted, except the fees earned on it.

Now, my understanding is the Federal Reserve is supposed to be an expert on safety and soundness as opposed to trade policy.

You, in your statement, make a big point of how this is bad trade policy. And I've got to tell you, Mr. Vice Chairman, I don't know what the expertise of the Federal Reserve in that area is.

What is unsafe or unsound about engaging in third country trade?

Mr. JOHNSON. First, let me just say that I don't see anything particularly necessarily unsafe and unsound about third country trade. I think though that our interpretation of the act suggested that export trading companies were to facilitate exports.

Senator HEINZ. I'm not going to get into whether you're doing the right thing or the wrong thing. I'm just asking you a question about a question which you've already answered.

I thank you. You've answered the question. Since I've got a lot of questions, let's keep going right along.

EXPORT SERVICES

Any reason we shouldn't count export services from the standpoint of safety and soundness, whether they're affiliated or not, whether they're related or not to the export of a specific good?

Mr. JOHNSON. I'm sorry. Counting?

Senator HEINZ. Counting for the purposes of satisfying the 50-percent test, the principally engaged test. There's no reason we should discourage export trading companies, bank-affiliated ones, from exporting services whether or not they're affiliated with the good, is there, from the safety and soundness standpoint?

I mean, the more they do, the more money they make. It's better, isn't it?

Mr. JOHNSON. I think there is a potential safety and soundness issue associated with an export trading company directly providing commercial services beyond the limitations set out in the act.

Senator HEINZ. What is the problem?

Mr. JOHNSON. For the same reasons that we have concerns for safety and soundness purposes on combining banking and commerce in the United States.

Senator HEINZ. There is admittedly a nonexclusive list of services in the act, but is there anything wrong with those? Are there any safety and soundness problems with the list that is provided in the act?

Mr. JOHNSON. I would have to review those again very carefully, but if they are of a financial nature closely related to banking, I

would not think that they represent a significant safety and soundness issue.

Senator HEINZ. Freight forwarding.

Mr. JOHNSON. That is a commercial function, and I think that could potentially put the bank at some risk.

That's why——

Senator HEINZ. Do you think that freight-forwarding is risky?

Mr. JOHNSON. I think it's potentially risky.

REGULATIONS PROPOSED ON BANK AFFILIATED EXPORT TRADING COMPANIES

Senator HEINZ. Let me turn to the question of the variety of regulations that you have attempted to impose on bank-affiliated export trading companies, principally by way of saying you've got to come to Washington, DC if you exceed certain limitations.

If a bank had an overseas subsidiary in London or Hong Kong or Tokyo, couldn't they set up an export trading company under the laws of those countries?

Mr. JOHNSON. I think that's right.

Senator HEINZ. And you could do nothing about it.

Mr. JOHNSON. I think that's correct.

Senator HEINZ. My question is why the Fed wants to manage export trading companies in ways that makes it impossible for them to do in the United States what they could do overseas?

Mr. JOHNSON. Well, I think that, once again, our concern is with trying to meet the spirit of the act itself that's been set up, and at the same time——

Senator HEINZ. I understand. I'm not being critical necessarily. I am critical on some specifics. But leaving aside your desire to faithfully interpret the law, which you should do, I'm asking again from a safety and soundness standpoint. If you want to put your trade hat on, if an American bank can do overseas that which you won't let them do here—leaving aside whether or not you're following the law—doesn't safety and soundness have kind of an artificial ring to it, if they can just go overseas and do whatever it is they want to do over there?

Mr. JOHNSON. I think the point is they can't do whatever they want over there.

Senator HEINZ. Under the law of the country in which they're operating.

Mr. JOHNSON. I'm sorry if I led you a little astray on that. We do have, if it's a domestic bankholding company that has a foreign affiliate in another country, we certainly do have a say over the kinds of functions that foreign-affiliated organizations can provide if it's a U.S. based company.

We have tried within the constraint of safety and soundness to approve services and functions for those foreign operations that allow them to be competitive in the markets in which they had to compete abroad, but we have still been very careful not to approve the type of functions for those foreign organizations that we think represent a safety and soundness problem.

But we've tried to be, at least let them be competitive with those foreign markets. So we have not approved everything. We have limits on the kinds of activities.

Now, we have approved securities underwriting of debt, underwriting of insurance, and a lot of financial functions. We have not approved controlling ownership in any commercial function that I'm aware of. And we have approved of engaging in financial services that have been necessary.

Senator HEINZ. Mr. Johnson, thank you. My time is expired. I hope to return.

Senator SARBANES. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. I'd like to ask a question of Mr. Bohn.

FEES BASED ON RISK FACTORS OF INDIVIDUAL NATIONS

Mr. Bohn, you mentioned that one of the initiatives that the Export-Import Bank was considering was a variation of fees based on the risk factors of individual nations.

Could you elaborate on how you were going to go about the process of determining the relative national risk?

Mr. BOHN. What we're going to do is the following:

The world, if you like, according to our present thinking, would be divided into probably six categories, one of which would be off-cover; that is to say that there is no "reasonable assurance of repayment."

We then, as most financial institutions do, will divide the countries into a series of what we perceive to be relative risk categories. Within the relative risk category, we will divide ours into essentially three categories. One will be sovereign; one will be usually quasi-sovereign risk; and, third, essentially all other.

The fee structure will be based on an overall objective to brake even. The purpose of the fee structure is not for us to make money. The purpose of the fee structure is for us to equate, as best we can, the risk that we are undertaking, and to compensate the taxpayer essentially for taking that risk.

Our belief is that, by doing this, we will be able to stay open over a longer period of time and avoid this off-again/on-again cover policy, which tends to come from a concern that there is really different risk in the marketplace today.

We had a risk system a number of years ago, but recently it has been the determination that all countries essentially represented the same creditworthiness. I think today it would be very hard to justify that kind of position. We have evidence all around us that there are very different credit risks involved.

Senator GRAHAM. How does this pattern compare to the method used by other major exporting countries? Japan and the European countries. Do they use a pattern that assesses a different level of risk and, therefore, charge?

Mr. BOHN. Yes, they do. We have made an extensive review of all of the other export credit agencies. All of them, with the exception I think of one, do this—that is, make a country-differentiated distinction.

Because of our concern about being competitive, we have, as I say, looked at all of these agencies and have proposed a fee structure that will make us highly competitive. Indeed, in the top credit areas, we will be the most competitive of any of the countries.

Where the impact will take place is in a number of the medium-term programs where the fee will actually go down from the current structure. It also will impact within the long-term area where we have essentially been charging a flat one-half of 1 percent. In the process, that will go into a differentiated fee structure. In the long-term programs, we are abolishing the existing 2 percent end fee and making the fee much more flexible in terms of who pays and how it's paid, so that the exporter has that option himself.

Senator GRAHAM. Based on the previous experience you indicated you've had with this variable fee, what status do you anticipate countries in Central and South America would fall in terms of their risk factor?

Mr. BOHN. It would simplify my life, and I suspect the lives of a lot of others, if I could give you a categorical answer to that. I really don't know.

Back in my commercial banking days, we went through a whole series of different kinds of calculations and ways of looking at this. My guess is that they will fall somewhere between category two and category four.

But, so much depends on the ability of the domestic managements of those countries to get a hold of their situation. You have examples from Mexico where they have taken extraordinary steps and seem to be doing a pretty good job. You have other examples where that management discipline seems to be lacking.

These categorizations will change; they're designed to change. But to pick out a given country at a given time really is a tough decision at best. And, in advance, I would say I just can't answer the question generally.

Senator GRAHAM. Thank you, Mr. Chairman.

Senator SARBANES. Mr. Bohn, I wanted to ask one question. As you note in your statement, last year, there was no piece of trade legislation enacted.

Are you seeking any further legislation at this time, or do you think you've got an adequate arsenal to meet your needs?

Mr. BOHN. Mr. Chairman, I think the legislation we got last year permits us to do both the kinds of things that the Congress wants us to do and that we think are necessary to meet the needs of the marketplace, and the changes in that marketplace that I outlined earlier.

Senator SARBANES. Mr. Good, is it your perception of the Export Trading Act with respect to the banks that those constitute a limited exception to the separation between banking and commerce for the specific purpose of trying to encourage exports?

Mr. GOOD. That's my understanding, sir.

HARNESSING FINANCIAL POWER TO INCREASE U.S. EXPORTS

Mr. LUFT. That's correct, Mr. Chairman. We view this as a controlled experiment to see whether or not we cannot harness some

of the financial power in our banking community for the specific purpose of increasing U.S. exports.

Senator SARBANES. How does your proposal now on third country trade activities harmonize or integrate with that limited and specific purpose?

Mr. LUFT. This has to do with the 50-percent revenue test as presently interpreted by the Federal Reserve Board.

The third country transactions, for example, by a bank-affiliated export trading company creates a transaction which sells an export from France to Germany.

This would qualify as presently regulated on the import side of the 50-percent revenue test. We believe that this is, quite frankly, absurd because for balance of payments purposes, that—the services, the fees earned from that transaction, to the extent that they are remitted count as a U.S. service export.

Senator SARBANES. Do you think that the facilitating of the export of a French-produced good from France to Germany should count as meeting the limited purpose of encouraging American exports?

Is that correct? Because of the fees earned from it?

Mr. LUFT. Yes. We feel that that would be more consistent with the balance of payments reporting of such transactions.

I'd like to expand on that a little. For an ETC to remain in business for the long run, all we have to do is look back to the environment since 1980. We had a massive increase in the value of the dollar.

During that period, a 50-percent increase in the value of the dollar made it very hard for anybody—either a manufacturer or a trading company—to successfully sell the U.S. produced good in a foreign market.

UNREALISTIC CURRENCY REVALUATIONS

Senator SARBANES. I know, but we can't operate from the premise that we are going to structure a system that is geared to totally unrealistic currency revaluations, and to Secretary Baker's credit, once he went to the Treasury, he began to address that problem and continues to address it.

I mean, I can't accept for a moment the proposition that because you have got this totally unreasonable situation on currency evaluation that that ought to be the basis that you are arriving at now for this proposal.

Mr. LUFT. If I can expand on that, Mr. Chairman.

The reason I cited the currency revaluation problem is that if you adhere strictly to the way the Federal Reserve Board is interpreting the revenue side of this equation, then of course it gets very hard to make the export when the dollar is strong. We need flexibility for the bank ETC's to weather this period because the contacts that a bank-affiliated ETC makes, even when it facilitates third country transactions, can then pay off.

Senator SARBANES. If the bank-affiliated ETC can meet its 50-percent test by facilitating the export of French made products to Germany, is not that ETC working in effect against American-made products which would like to be sold to Germany?

They are helping the French-produced products and French jobs to be sold in Germany. I thought the purpose of these companies and the limited exception that has been given for the Commerce banking line was to encourage American-made exports.

Mr. LUFT. The facilitation of such a trade transaction does have an American export component. It is the service.

Senator SARBANES. The fees are earned by the bank export company, is that right?

Mr. LUFT. That is the component.

Senator SARBANES. And you think the Congress, when it passed the bill, was thinking, when it was talking about encouraging exports, that the fees would be adequate even though the exports being encouraged were foreign-made exports, is that correct?

Mr. LUFT. I wouldn't characterize that as adequate, but one has to give the flexibility to the ETC to respond to the current macro conditions. Let me give you an example.

The Japanese trading companies earn between 15 to 20 percent of their revenues from third country transactions. In 1983, the nine largest Japanese trading companies benefited the Japanese balance of payments. To the extent that these earnings were remitted, the sum was $60 billion. That is a not an insubstantial benefit to the Japanese balance of payments.

At a time in which we are facing a trade deficit of enormous magnitude, who is to say that the export of the service is worth less than the export of the good?

I think that is the kind of question that we have to face up to. If we can redress our balance of payments difficulties in a period in which U.S. goods are not competitive, through no fault of their own but merely because of currency movements, then should not the ETC be able to take advantage of such a situation?

Under current regulations they simply cannot.

Senator SARBANES. Where are the jobs in all of this? The jobs are abroad, not here, is that correct, except for the few jobs at the top of the ETC that are drawing the financial support from this activity? Would that be correct?

Mr. LUFT. Only in the short run. In the longer run, as we have seen, the dollar comes down, and allowing the bank ETC to engage in these kinds of transactions during the unfavorable macroeconomic period creates the kind of contacts which then can be used to facilitate the U.S. exports when conditions improve.

Senator SARBANES. Do you argue for this activity in a favorable macroeconomic context?

Mr. LUFT. In a favorable macroeconomic context, I would expect the U.S. goods, as is presently the case, to be more competitive.

Senator SARBANES. No, do you argue for this activity in that context, or is your argument for it only in the context of this highly unfavorable macroeconomic environment?

Mr. LUFT. I argue for it in the context of increasing the flexibility of the ETC to respond to market conditions.

Senator SARBANES. I have run over my time.

Senator Heinz?

Senator HEINZ. Mr. Chairman, I might just make the observation that in this day and age of mixed economics—I couldn't help but recollect that Senator Sarbanes and I went to China last May—it is

entirely possible to conceive of the Chinese going to an American company and saying, before we are going to do any business with you, we want you to sell some Chinese iron ore to Korea or Taiwan.

It seems to me that there is a great deal, not just of good will, but of valuable marketing relationships that can be built up through third-country trade. Just as advertising Proctor & Gamble soap builds a market in the United States for Proctor & Gamble products, the ability of a United States-based trading company to show that it can sell as well as buy, develops marketing links, sales expertise, contacts, things that are of tangible value to American exporters, if not in the first instance then down the road. Indeed we are pursuing a very similar arrangement at this time in my home State of Pennsylvania in an effort to sell the People's Republic of China some General Electric engines for their railroad system. This involves some third country trade and means literally several thousands of jobs.

We are not going to be able to do it on a cash basis. We are going to have to help the Chinese sell some of their other commodities to some other part of the world in order for us to sell several dozen General Electric diesel electric locomotives produced in Erie, PA.

Isn't that the kind of thing that we are talking about, Mr. Luft?

Mr. LUFT. In a nutshell, that is it exactly.

To go back to the French-German example that I cited, your case would be that we want to sell the locomotives to France but the French will not want to pay in cash, so they will provide some kinds of goods which then have to be sold somewhere else, not necessarily in the United States.

In order for this entire transaction to come to pass, we need the ability to do these third country transactions.

Senator HEINZ. Sometimes those are not even tied transactions.

Mr. LUFT. Absolutely.

Senator HEINZ. I want to make that point. They are not necessarily tied transactions. There are other things you get, you need to do, whether or not they are tied; would you not agree?

Mr. LUFT. I agree with that.

LEVERAGING RATIOS

Senator HEINZ. Now, let me ask Mr. Johnson one other question. It has to do with the leverage issue.

Now, you object to a 25 to 1 standard as being too different from the standard for banks, yet as we know, export trading companies aren't banks and the Fed has a variety of standards itself. I understand that primary traders are required to have 6 percent capitalization. That is about 18 to 1. Goldman Sachs has a 50 to 1 ratio.

What is the magic of the current 10 to 1 standard used for ETC's by you as compared to some of these other standards that are used?

Mr. JOHNSON. We don't have a strict 10 percent standard. We have a flexible standard, and we evaluate the capitalization needs on a case-by-case basis, depending on the activity of the export trading company.

procedures that will permit us to . lance diplomatic sensitivities over country rankings with our need to differentiate risk. We will seek to clarify or eliminate the distinction between political and commercial risk coverage.

There's more we plan to do. Our Small Business Task Force has provided other ideas to help us meet the special needs of small businesses interested in export sales. Our Board is reviewing their recommendations and has already acted to simplify, clarify and modify the Working Capital Guarantee Program to make it more useful to more potential exporters. Our Advisory Committee group looking at the issue of foreign content submitted recommendations on foreign content which we are examining. Finally, we will seek to establish a more effective system of delegated authority to the banks.

I would like now to address in some detail the other two directives that Congress enacted. Several provisions were passed which deal with the issue of the domestic economic impact of transactions authorized by us. Let me say that we recognize the extremely sensitive nature of this issue. We realize that at any given time some members of Congress may be in favor of our supporting a transaction because of its helpful impact upon exports sales for U.S. suppliers, while other members may be as vigorously against it because of concerns about the potential negative impact upon domestic industries competing with foreign producers. Based upon the recent legislation, we have developed detailed procedures that focus on determining whether Eximbank's involvement in a foreign project will be significant and whether the project's adverse impact on U.S. industry will be substantial. We will seek to determine whether the general benefits to the U.S. economy can justify support by Eximbank for exports for a project, the output of which may have substantial adverse economic impact in the United States. If the Board cannot answer that question in the affirmative, we will deny support for a transaction. Our reasoning will be well-documented and address the views of parties which may be adversely affected by the transaction.

Turning to the issue of mixed credits, our tied aid credit program -- the so-called "war chest" -- is in place. Your directive wisely recognized that the limited amount of resources that we will be able to commit in this area should be targeted in ways to encourage negotiations to end the practice of using tied aid for commercial purposes.

The U.S. Government has been negotiating for three years with other OECD countries in an effort to reach agreement on a sharper distinction between development assistance and financing of the kind Eximbank provides which is at or close to market rates and terms. In order to bring pressure to bear upon the negotiations, the President proposed legislation and funding in September 1985 for a war chest. Eximbank itself began making offers of mixed credits to support our negotiating efforts -- that is, we have offered either a combination of grant and regular loan or soft loan (for example, 2 percent interest, 10-year grace, 20-year repayment) and regular loan.

In the 1986 legislation Congress recognized the need for an aggressive approach to be taken with regard to tied aid credits and provided funding which can be used for future business as well as for the business which U.S. exporters won during FY 1986 as a result of the initial offers Eximbank made. Eximbank has made twelve offers of grants or soft loans for specific transactions which might be funded from the war chest. U.S. exporters have won 5 of these cases, one has been lost and six are in various stages of review by the borrower. We have also authorized two concessionary lines of credit of a hundred million dollars each to Indonesia and Thailand.

The results have been not only gains for exporters on these particular transactions, but progress as well in our negotiations. A specific proposal was negotiated January 22-23 which the twenty-two participants in the OECD Arrangement on Export Credits, including the United States and the European Economic Community (representing twelve countries) have accepted. This proposal will raise in two stages the minimum permissible grant element from the current 25% to 35%, and it will greatly improve the manner in which a grant element is calculated. We expect technical details to be settled in April so that the first stage can go into effect on July 1 of this year and the second stage a year later.

Under the first stage, restrictions will be somewhat tightened on the use of tied aid for commercial purposes, while the second stage will represent an even more effective deterrent by making it extremely expensive for all countries to use their aid budgets to steal business. They may still do so occasionally, but the tighter rules are expected to result in most development assistance being used for its rightful purpose. During the interim period until the tighter rules of the second phase

become effective, we will continue to use the $100 million appropriation you provided to us in FY 1987 as well as the $200 million we are requesting for FY 1988, if approved, to make sure that U.S. exporters are not squeezed out of projects because of predatory financing offers falling in the soon-to-be eliminated "no man's land" between export credits and truly concessional aid.

Mr. Chairman, just because the life of the Bank has been extended for six years does not mean that we do not intend to continue to cooperate closely with our oversight committees. We must make sure that the programs we are proposing will work. It has been a great disappointment to all of us that the level of Bank lending activity remains so low this year. One reason is the time lag between the devaluation of the dollar and the ultimate benefit to our balance of trade. Another is the continued weak economic performance of many of the less developed countries that constitute some of our major markets. And another reason may well have been that the terms and conditions of our programs could have been more flexible in responding to exporters' needs. In the next year, we intend to make a difference.

At the same time, we must make sure that Eximbank is able to continue to operate efficiently and in a responsible fashion. Within the next year, we expect to trigger Section 14 of our Act which requires us to notify Congress when the level of our capital stock and earnings falls below fifty percent of the value of our stock and earnings at the end of fiscal year 1983 ($1,396.2 million).

Mr. Chairman, with the help of the exporting and financial communities and with the tools Congress gave us in 1986, we will build a new Eximbank more vigorous and responsive than ever to the needs of our exporters. We will encourage commercial financing institutions to support U.S. exports, we will provide our financial support where the private sector cannot or will not participate and we will continue our efforts to match and eliminate the unfair financing practices of other countries. Together we can take a major step toward restoring the competitiveness of the American exporter.

Thank you. I will be pleased to answer any questions you or the members of your Subcommittee may have.

As I said, we have approved some applications for ETC's to leverage up to 17 to 1, depending on whether they were taking on a bank-related function in terms of financing exports.

So we have been flexible. I think, though——

Senator HEINZ. So you really don't object to higher leveraging ratios; you have a concern about the safety and soundness involved, which may be quite independently related to a specific and necessarily arbitrary ratio, is that correct?

Mr. JOHNSON. We think we can evaluate the safety and soundness issues on a case-by-case basis on the capitalization.

Senator HEINZ. You would take capitalization into effect, but it would not be the basis solely by which you would approve or disapprove an application?

Mr. JOHNSON. An across-the-board capital standard I think could be somewhat arbitrary, and so we do look at it on a case-by-case basis.

Senator HEINZ. I am trying to rush you along because of that red light on which we trespass.

I think that is the point. Any across-the-board standard is necessarily arbitrary. It is not that it shouldn't be taken into account. It is just that it shouldn't be the determining factor because you and I both know and we both agree that it is inherently arbitrary.

Thank you, Mr. Chairman.

Senator SARBANES. Senator Graham.

Senator GRAHAM. Mr. Chairman, I would just like to pursue the line of questioning that you were asking.

I can accept the fact that it is desirable for the United States to develop expertise in Third World trading relationships, that it is necessary for U.S. based export trading companies to have an institutional base of support that will sustain them through good times and bad times and that those Third World trading relationships are often necessary to achieve U.S. trade.

I think the question that the chairman was asking was not a question of those values, but rather why should banks as a specialized institution be encouraged to be the entity to be called in those kinds of relationships.

What is it about a bank as opposed to a nonbank export trading company that gives it an expertise or capacity in those Third World trading relationships that would warrant the kind of accounting procedures that you are advocating which justifies the further infringement on the line between banks and commercial activities and safety and soundness concerns?

Mr. LUFT. Thank you, Senator Graham.

The way I would like to answer that is I see the banks—being a former banker myself in international banking—as having a distinct comparative advantage in, No. 1, having a very large network of foreign branches and affiliates.

This leads to the second advantage which they have, which is information. Many of the customers who are lenders or borrowers from the bank would also be potential customers for the export trading company.

The clearest thing, of course, is that what the bank affiliation can bring is the ability to finance the international trade transaction, and this is precisely very important in today's environment in

which we are facing increasing global competition and our ETC's have to compete with foreign ETC's, and most of the successful ones have some form of bank affiliation.

The Japanese trading companies are clearly the case. It was mentioned earlier that the Japanese bank is only allowed to hold 5 percent of the equity of the ETC.

I would like to point out that this is sustantially different from our regs. Our regs say that the holding company cannot put more than 5 percent of its holding companies' consolidated surplus and capital into the ETC. The Japanese regs say the bank may not hold more than 5 percent of the affiliated ETC's capital. That means potentially that 5 percent is worth more than the 5 percent of the consolidated surplus of the parent bank.

If we are indeed in a global marketplace, and I think we are, then the level playing field that we have to be looking at is the foreign competition.

I mentioned that the Japanese trading companies put 15 to 20 percent of their income, if they develop that, through third party trade transactions. I had these companies as customers when I was a banker in Germany. I found that they did an awful lot of business not exporting Japanese goods but facilitating the export of German goods, the import of goods outside of Germany, and totally third country transactions, all of which rebounded to the benefit of the Japanese balance of payments.

If we are to compete in this kind of a global marketplace, then we have to show some kind of flexibility for the bank-affiliated ETC's to make use of these comparative advantages that they already possess, put those advantages to work so that you can create the framework, the contacts that will generate increased U.S. exports.

Senator GRAHAM. Thank you.

Senator SARBANES. Mr. Luft, I want to pursue this one for 1 minute.

Under the current regulations of the Federal Reserve, as I understand it, a bank export trading company could do quite a bit of this third country business. In fact, it could do up to 50 percent third country business. The only requirement is that they at least produce 50 percent of their revenues out of encouraging American exports, is that correct?

Mr. LUFT. That is correct.

Senator SARBANES. So in the example that was cited earlier, even if it wasn't tied but if you are trying to structure that relationship, as long as you stayed at a 50/50 level, you could do it under the current regulations of the Federal Reserve, is that correct?

Mr. LUFT. That is correct.

Senator SARBANES. Now, what you are seeking, I take it, would be the opportunity for a bank export trading company in effect to do nothing to encourage the export of American goods.

Under your proposal, such a company could in effect engage totally in third party activities, is that correct?

Mr. LUFT. I think that that would go contrary to the act because the act says it must be principally engaged in U.S. exports.

Senator SARBANES. That is right, and the Fed has defined that with the 50/50 rule. You want to drop the 50/50 rule in the sense

of being able to count third party activity as meeting the 50 percent requirement.

So if they can count third party activity to meet the 50 percent requirement, that in effect then becomes principally engaged in facilitating U.S. exports. Of course, the other 50 percent is not in the requirement anyhow. They in effect would do nothing to encourage U.S. exports and still qualify under your proposal.

Mr. LUFT. I see a problem with the 50-percent revenue test as currently constructed because of this linkage, for example, as I mentioned.

Senator SARBANES. No, I want to understand your proposal. Your proposal is to count in the 50 percent for encouraging American exports third party trade.

Senator HEINZ. Mr. Chairman, I just want to be clear. Is it third party trade, or is it just fees earned?

Mr. LUFT. Just the fees.

Senator HEINZ. I just thought you two were talking on some different wave-length.

Senator SARBANES. No, I understand.

Mr. LUFT. The earnings.

Senator HEINZ. The earnings, not the volume.

Senator SARBANES. So what would have been done to encourage American exports under your proposal?

One of these companies could function without encouraging any American exports. Is that correct?

Mr. LUFT. The fee itself is a U.S. service export.

Senator SARBANES. Aside from that.

Mr. LUFT. Theoretically, it could, but I think that that would not be the case in practice.

Senator SARBANES. Thank you. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you. I'd like to submit my statement for the record, if you please.

Senator SARBANES. It will be included.

STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I would like to think that today's hearing on export promotion is focusing on the positive side of the trade deficit problem. U.S. exports are of course a mathematical plus. They represent the cash earnings we use to pay for our high standard of living without depending on massive and destabilizing inflows of foreign capital.

However, while our imports have risen more than 40 percent in 5 years, exports are actually below 1981 levels and we have become the world's largest debtor. It is hard to rate performance like that as anything but negative. Should we blame government? Certainly a major part of the problem is foreign trade abuses, an overvalued dollar, and slow growth abroad. But our own export policy failures are clear—irrational regulation of our export trading companies and export control system and poor performance by the Export-Import Bank.

I am certainly willing to go after our trading partners for abusing the trade system, but this is one area where we are repeatedly

"shooting ourselves in the foot." I hope today to build a case for some changes in law that will remedy this situation.

Our hearing today does some old business and some new business. We are reviewing progress made since last year when we redrafted the Eximbank charter and created a tied-aid war chest to combat predatory tied-aid financing. I look forward to a report from John Bohn and the exporters that the Bank's programs have become more accessible to exporters and fully competitive with our trading partners. I am also hopeful that we will hear that the tied-aid credit agreement struck last week in the OECD will resolve the tied-aid problem when fully implemented in 1988.

Our new business is really not new either since we are returning to two issues on which the committee reported legislation last year—export trading companies and Commerce trade data system. My bill, S. 653, covers both of these issues. Its most significant provisions deal with banks ETC's, and are supported by the administration and by the findings of a 1986 GAO study on bank ETC's which I would like included in the record of today's hearing. Most of these provisions were also reported by the committee at my urging last year.

Since this hearing is a reprise of our deliberations last year, I am hopeful that after today's testimony we can all agree to include my proposals in the committee's trade bill. Thank you Mr. Chairman.

COLLATORALIZATION REQUIREMENTS

I have one last question for Manny Johnson, whose been most responsive. I thank you, Manny, for your responsiveness. I want to be sure I understand something with respect to current practice of collatoralization requirements.

Am I right that a bank may invest in up to 5 percent of the capital of any type of company without the presumptions of an affiliate relationship?

Mr. JOHNSON. That's correct.

Senator HEINZ. Am I also right——

Mr. JOHNSON. Well, without the assumption of control, yes.

Senator HEINZ. Am I also right that under that kind of circumstance, a banker may lend to that company free of the requirements of 23A collatoralization requirements?

Mr. JOHNSON. I think that's correct, yes.

Senator HEINZ. So a bank can hold 5 percent of the capital, 4.999 percent of its capital and surplus, of a company. It can lend free of 23A as long as that company is not an export trading company.

But, if as I understand your position, a bank could put the same amount of its capital into an export trading company, and we should treat the export trading company differently than we treat any other kind of company and we should apply these very strict collatoralization requirements.

Why?

Mr. JOHNSON. There's a slight difference, Senator.

The 5-percent rule is the amount of voting shares of the company that it's acquiring stock in. Not its capital. It's not a 5-percent rule as a percent—I'm sorry—of the bank holding company's capital. Five percent ownership in the shares of the acquired.

Senator HEINZ. That might be 5 percent of its capital, too, you know.

Mr. JOHNSON. It's possible, I guess, but I'm just simply saying——

Senator HEINZ. Let's assume it's 5 percent of its capital—we can argue about whether it's controlled or not. Then the question is not so much collatoralization requirements as the issue, but how you make sure that it is an arm's length transaction.

You've got a rule that says if you only own 5 percent of the company, an arm's length transaction is presumed to exist.

I'm really only trying to make the point with you that what you're doing with the collatoralization requirement is to structure and guard against what you fear in the way of nonarm's length transactions.

And all I really want to suggest is that there are other ways to do that rather than apply 23A.

Mr. JOHNSON. Yes, but I think the important point is that there's a totally different issue at stake when you're talking about affiliated organizations within a holding company structure, because there's potentially not an arm's length credit test.

Senator HEINZ. You know, that's really at variance with the position of the Fed with respect to subsidiaries, independent subsidiaries, conducting securities activities in the United States, where the Fed comes up and other people come up and say:

You can have subsidiaries undertake this activity, you know, because they're separate, because they're independent. Not to worry. There are no possibilities for tie-ins. Not to worry, there are no possibilities for conflicts of interest.

It sounds to me, and maybe I'm mishearing you, but it's OK, as I understand the Fed's position on these issues, for banks to engage in these other activities in the United States. And they're presumed to be independent.

Mr. JOHNSON. 23A would apply.

Senator HEINZ. You're sure?

Mr. JOHNSON. Yes.

Senator HEINZ. That's what's been proposed.

Mr. JOHNSON. Any nonbank affiliate of a bank—securities activities or any other activity—would fall under the application of 23A.

And so we would provide strict limitations on the lending practices of a bank to any nonbank affiliated organization. Any financial activity. Any affiliated organization.

Senator HEINZ. And we regulate foreign bank subsidiaries in this country in the same way.

Mr. JOHNSON. Any U.S. bank holding company affiliate.

Senator HEINZ. If a foreign bank has an affiliate in this country, we regulate it the same way.

Mr. JOHNSON. No. A foreign bank that has a bank subsidiary in the United States has to meet U.S. standards for banks.

But, in terms of the capitalization and lending requirements of its parent overseas, we don't really have control of that.

Senator HEINZ. No, I meant its operations in the United States is what we're talking about.

Mr. JOHNSON. Yes.

Senator HEINZ. And if there's, in effect, a holding company with a subsidiary, we regulate them.

I guess the only point I'd make is export trading companies aren't operating in the United States, they're operating overseas. And what you've said is that we're regulating them as if they were doing business in the United States when, in fact, we know the sole purpose of their existence is to do business overseas.

Mr. JOHNSON. I think we're sympathetic to that point. That's why I think we have supported the notion of a specific commercial function for export trading companies, which is to facilitate exports of goods and services from the United States.

I think our view though is that that function ought to be limited strictly to the facilitation of exports and should not get into other direct provision of financial services or any other commercial services; we allow an export trading company to enter into a joint venture to provide any of these functions, to combine any financial service with any other trading function.

And so we see the export trading company as an entity that ought to be facilitating trade, not directly competing with other U.S. providers of goods. That's why we think they ought to be a facilitator.

Senator HEINZ. That's with your trade policy hat on.

Mr. JOHNSON. That's what our interpretation of what "export trading company" means.

Senator HEINZ. My time is expired. Thank you.

Senator SARBANES. Mr. Johnson, I'd say to you I think it's a perception of many Members of the Congress that a very limited exception was granted to the line between banking and commerce for the purpose of encouraging American-made exports; that while it says you're wearing a trade hat, I think, in effect, you're wearing a hat interpreting the intent of Congress.

Now, we may have a difference here about whether the law should be changed. But I think that was the intent when the existing law was put into place.

So, in that sense, I think the Fed is working within the parameters put up by the Congress.

Mr. Bohn, I wanted to just say, first of all, I wanted to say that I can recall in this committee joining with Senator Heinz when he was pushing very hard for the war chest for the Eximbank. If we didn't really compete at that level, we weren't really going to be able to get any agreements.

So I joined with Chairman Proxmire in welcoming the agreement that's been gained, although, obviously, one could wish for different specifics—and you admitted as much yourself.

Is it the intention that you'll continue to monitor this issue very closely? I take it it's going to be implemented in stages?

Mr. BOHN. That's correct, Senator.

Senator SARBANES. Of course, you argue for retaining there sources in the interim in order to be able to keep it on the straight and narrow.

But, even beyond that, are we still thinking eventually of trying to further alter the terms of the existing arrangements as they're put in place?

GRANDFATHER A NUMBER OF TRANSACTIONS

Mr. BOHN. I think, Mr. Chairman, the answer to that will depend on what happens between now and July 1988. What I expect will happen is, if history is any guide, there will be a scramble to grandfather a number of transactions which are currently in the pipeline, so that between now and July 1988, we will have to remain vigilant and indeed be prepared to match the support of our own exporters this kind of activity which I suspect will take place.

Thereafter, it is clearly still our intention to try to get the grant element up higher and to try to carve or erect a wall between this use of aid to buy a commercial business which redowns to the detriment of American exporters.

At that stage, Mr. Chairman, however, I think we have a broader issue. Even if we are successful—that is to say, we do raise the grant element 40 or even 50 percent, the issue will still remain, I submit, that some countries will continue for national policy reasons to subsidize exports in order to keep their factories going, or whatever the reason is.

This, I would submit, is a much broader issue that needs to be dealt with. Heretofore, we in this country have separated—quite rightly, I would submit—the use of aid funds from the use of trade facilitation funds.

The issue then becomes if another country is prepared to subsidize exports—call it aid, call it development assistance, call it what you will.

And if the result of that subsidy is to unfairly prejudice American companies competing for that market, then what, if any, response should the United States have?

I think that's a much broader question. But that question will remain, I submit, whether or not we get compliance with this agreement, even if we were to go beyond it.

Senator SARBANES. Gentlemen, thank you very much. You've been a very helpful panel.

If the next panel will come forward, we will proceed with the balance of the hearing. [Pause.]

We're prepared to proceed. Mr. Rosenberg, would you go first? Then we'll go to Mr. Barovick, and then to Mr. Nelson. We'll take your entire statement and include it in the record. And if you'll touch the high point, we'll appreciate that very much.

STATEMENT OF KENNETH W. ROSENBERG, PRESIDENT, FIRST INTERSTATE TRADING CO.

Mr. ROSENBERG. Thank you, Mr. Chairman. I am president of First Interstate Trading Co., which is a bank-related affiliated export trading company operating under the act. I'm here to tell you that the act is working properly for our purposes.

There are some things that can be done to improve our ability to be competitive. But, in fact, we are successfully carrying out the intent of the Congress when the act was passed.

In the prepared remarks, I indicate that we have been very successful in exporting product from the United States. We also participate in imports and we participate in third country transac-

tions. Our entire intent in the participation in imports and third country transactions is truly to facilitate exports of U.S. products.

The reason that it is necessary for us to involve ourselves in imports and third country transactions to facilitate U.S. exports are several.

LACK OF FOREIGN EXCHANGE AVAILABILITY

One of them is that, in many instance, dealing in Third World countries, if you will, it is impossible for those countries to purchase U.S. products due to a lack of foreign exchange availability.

We, therefore, enter into countertrade transactions which will allow those companies to purchase goods produced in the United States.

An example of this is business we are currently doing in Peru, where we're importing products from Peru into the United States and using the funds, the foreign exchange generated by those transactions, to sell U.S. electronics equipment.

It is essentially a one for one transaction. So we are creating the opportunity to sell products that could not be sold under other circumstances.

Another issue was touched on by Mr. Luft. When we are dealing in third country transactions—let's stick with Peru for a moment and use that as an example.

If we're selling a product from Peru to Brazil, that also creates the opportunity to do a countertrade transaction and sell U.S. product as a result of the U.S. dollar earnings for Peru.

The issues as far as 23A are concerned, I would have to speak for myself and then also attempt to speak for a moment for the rest of the export trading company industry.

As far as we are concerned at First Interstate Trading Co., 23A does not present a problem in the transactions that we engage in. Our business is to take title to product to facilitate the transaction. And it is exactly that part of the act that permits us to be successful in our activities.

We replace the U.S. exporter in a transaction in order to assure that when the bank or ourselves are engaged in that transaction, we have control of performance.

The real problem for the small to medium-sized company is that they cannot attract bank financing because a bank has no secondary source of repayment and is very concerned about the performance of that company, and their actually completing that export.

By our becoming a principal in the transaction, we complete the export or can on the failure of that company to do so. That enables us to finance and to participate in transactions that the bank is unable to do.

The provisions of 23A, therefore, have no real effect on our activity other than the fact that we have to provide securities to the affiliated banks who lent to us in those particular transactions.

Now, speaking with my counterparts or peers in the money center banks, they are using their export trading companies in a slightly different manner.

It is their intention to use that vehicle to serve the small and medium-sized companies and no other banking mechanism. They

find themselves in a position of lending to those companies rather than participating in taking title in the transanctions.

Therefore, they feel they need some relief from the provisions of 23A in order for them to act as a lender and pass on the funds that they in turn would borrow from their affiliated banks without the necessity to provide that 100 to 120 percent collatoral.

The assets to equity issue is also one that we feel there should be some relief given on. That again is because, as we engage in a higher and higher volume of trade, it is necessary for us to continue to return to the parent organization an acceptable level of profit.

As we get into more and more transactions, oftentimes very competitive with Japanese or Korean trading companies, we find that the margin on those particular transactions will be squeezed to a very, very thin profit margin.

Without the leverage capability, we are simply unable to engage in those transactions because the profitability is simply not adequate to provide proper return on our equity.

That is the major reason for our concern that we have some relief from the 10/1 debt equity requirements.

I think I'd like to stop there and answer any questions that you might have.

[The complete prepared statement of Kenneth W. Rosenberg follows:]

STATEMENT OF

KENNETH W. ROSENBERG

PRESIDENT AND CEO

FIRST INTERSTATE TRADING COMPANY

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

SENATE BANKING COMMITTEE

MARCH 25, 1987

Mr. Chairman and Members of the Committee:

My name is Kenneth W. Rosenberg, and I am very pleased to be invited to appear before the Committee today to express my organization's strong support for legislative proposals to enhance the competitiveness of export trading companies owned by bank holding companies. In particular, we are pleased to support S.653, introduced by Senators Heinz and Garn.

I am President and CEO of First Interstate Trading Company ("FITC"), the fourth Export Trading Company ("ETC") to be authorized under the ETC Act of October 1982, and I have held that title since July 1985. FITC is a very successful ETC and is currently well ahead of the original projections provided to the Federal Reserve Board ("FRB") in our application.

FITC is a wholly owned subsidiary of First Interstate Bancorp, Los Angeles, California, the 9th largest banking organization in the United States, controlling 23 banks located throughout the 12 Western States.

At the end of 1984 FITC had completed $1 million in sales and incurred the losses to be expected in a start-up company. In 1985 we achieved $3 million in sales and reduced the losses to nearly break-even. Last year (1986) we completed $43 million in sales with a reasonable profit. Our sales projections for 1987 show $200 million with a profit level that will exceed First Interstate Bancorp's target for return on equity.

FITC has 19 employees, 11 in the Los Angeles headquarters, three in Seattle, WA and, as of March 1, 1987, five here in Washington, D.C. We have in-house capabilities to provide a full range of export services in support of our international trade transactions. We have followed a careful policy of expanding our staff and overhead costs only when business justifies the added cost. FITC has been and is currently in full compliance with the FRB's regulations.

A key element of the ETC Act is the authority to take title to product in the normal course of an international trade transaction. There are many companies in the U.S. today that have the ability to negotiate major export sales but lack the financial and/or administrative capacity to complete the transactions. Banks are unwilling and unable to provide the necessary funds since they are asked to assume the performance risk of the exporter with no secondary source of repayment in case the transaction is not completed. Typically in our experience, a small or medium size company will have negotiated the sale of a $2-10 million production facility to, for example, a Chinese ("PRC") buyer and obtained a letter of credit from the Bank of China. They must then purchase the production equipment from several vendors, arrange for delivery to a point of export and produce the proper documents to obtain payment under the letter of credit. They normally first attempt to obtain terms from the vendors by which the vendor agrees to wait for payment from the Chinese letter of credit, but rarely will suppliers accept such terms. The next approach is usually to an international bank with an attempt to borrow against the contract and letter of credit. Finding the banks unwilling, the exporter must then look for some investor or guarantor to cover the performance and payment risk. A bank-owned ETC can become a principal in this kind of transaction through assignment of contract rights. The ETC then will purchase the equipment from the vendors, arrange shipping, insurance, documentation and payment thereby controlling performance. It is this authorized activity that has allowed FITC to become successful.

There are, however, certain restrictions imposed by both the ETC Act and the FRB that have a negative impact on our ability to achieve the Congress' intent to promote exports and increase employment. We believe amendments to the ETC Act would reduce the negative impact without affecting the safety and soundness of the U.S. banking system.

We believe that, as provided in S.653, the definition of "export trading company" should be amended to (1) allow revenues from third country transactions to be treated as export-related in the determination of whether the income from an ETC is derived "principally" from exports; and (2) permit the export of services by ETC's and their affiliates to be included as ETC export-related income.

To illustrate, from time to time FITC is asked to act as an intermediary in a trade transaction between countries that lack diplomatic or trade relations. In effect, we purchase goods from one country (for example Korea) and sell them to another (for example China). The sale is denominated in U.S. dollars and our fee is paid in U.S. dollars, thereby having a positive effect on the U.S. balance of payments. These transactions are frequently done by Japanese trading companies that earn yen for the service and employ a

Senator SARBANES. Fine. Thank you very much for a very helpful statement.

Mr. Barovick.

STATEMENT OF RICHARD BAROVICK, EXECUTIVE DIRECTOR, NATIONAL FEDERATION OF EXPORT ASSOCIATIONS

Mr. BAROVICK. I'm standing in actually for Ralph Chew, the president of our Federation and of Chew International Group, which is a successful export management company. But I will present his statement for the record.

I'd like to cover a few points. Three points specifically, if I may. Just one moment on our own organization, the National Federation of Export Associations, which was created in 1984 to provide a voice in Washington for the export management company industry. It was revived in January of this year and I was asked to serve as the executive director.

It consists of the export management company associations in New York, Chicago and Los Angeles as well as the Overseas Automotive Club, whose membership is nationwide.

We have 500 members, export management companies are the export departments or representatives of small manufacturers, and they focus almost exclusively on exporting.

I'd like to address three issues. One is the bill on the table, the Bank Export Trading Company bill, and specifically on the provision for being principally engaged in export.

I don't think it's within our capability or interest to address ourselves to the other regulatory aspects of the Bank Trading Company bill.

Second, I want to talk a little bit about what the bank trading company parts of the Export Trading Company Act of 1982 has meant to small exporters; and, third, to comment just briefly on trade finance.

OPPOSITION OF THE BILL

We are opposed to the bill on the table proposing that principally engaged can be interpreted to mean that third country transactions are to be counted as exports. We have a number of problems with it.

First, it's an invitation to abuse, we feel, by a money center bank that could simply engage wholly in third country transactions; do no exports from the United States; and qualify for the 51 percent rule under the law.

Second, it would split the banks into two groups—a handful of large banks that would utilize such an invitation, and who are few and far between, and the bulk of U.S. banks, including those that have set up bank trading companies, who couldn't get into such activities.

I'd also like to point out that, in our own group, our companies have managed to export only don't import, and don't do third country transactions. Some of the companies in the group—not too many—do $50 million or $100 million worth of business, and they've been around for 60 or 70 years.

The best proof of what I have to say, however, is seated on my right. Ken Rosenberg has done a magnificent job. I followed the activities of his company; it's a model for bank export trading companies. He has demonstrated two things beautifully.

No. 1, if a bank wants to export through a trading company, it can do so.

No. 2, if a bank wants to do so under the present regime of rules by the Fed, it can do so. We are not unmindful of the problems the banks have had in the trading company arena. They got into it at the worst possible time in terms of the external environment.

However, although it seems reasonable for them to have some more time to come into compliance, and perhaps the third country transactions might simply not be counted at all, to count them as an export, we feel, would be objectionable and an invitation to abuse.

I can comment briefly, if you would like, about all of the bank trading companies in the country. I've spoken with every one of them. And I can give you in about 2 minutes, if it's of any help, a rundown of what they do.

Of the 42, 12 have dropped out completely. About three still exist on paper, just sort of a shelf item. If they need a trading company to take title, do a little bit of consulting, they're still around. About six are still alive but not doing much.

Of the remaining ones, there are basically three roles and sometimes they mix. A number of the banks that have developed trading companies are using them for trade finance roles, as Ken Rosenberg pointed out. And those are primarily the large money center banks.

There are a few that have developed trade services. I can identify three. Chase Manhattan has a foreign sales corporation management firm. Marine Bank in Milwaukee has the same. And First Union Bank in Charlotte, NC, used the law to acquire two freight forwarders.

The remaining banks in the field combine trade finance or, as Mr. Rosenberg has pointed out, his role is to help provide a financial capability to make deals fly, with some actual marketing.

His company is the only one that has a real success story on the development of U.S. exports.

On another issue, I would like to just comment on what the 1982 law has meant to us. On the antitrust part, just by a fluke, as it were, the 1984 Shipping Act, combined with the 1982 Export Trading Company Act made it possible for exporters to team up in the creation of shippers' associations. That means that exporters can band together and negotiate more favorable freight rates with ocean shipping lines.

National Association of Export Companies, Inc. [NEXCO], which is the New York-based branch, so to speak, of our Federation, set up a shippers association and I am happy to report that it has acquired considerable membership, including some larger companies that have come into the fold for that purpose.

On the bank ETC's the program of our Federation is not just to have a voice in Washington but to engage in business development, so we are talking to the banks around the country. And I find that a few banks, including one in New York with an ETC, are interest-

ed in talking with us about doing business on behalf of our small business exporters.

And I know that Mr. Rosenberg's bank has done so in the Western States. But I guess what piques us about the 1982 law, reminds me of a remark I once heard Carlos Romulo say, he was the Foreign Minister of the Philippines at the time. It was a long time ago.

He said, "You know, in 1519, or whenever, Magellan sailed across the Pacific Ocean and discovered the Philippines, and there we were." And, in 1982, Congress in its wisdom discovered trading companies, and there we were.

And we would hope that our small industry would somehow benefit from the trading company law. We are not happy that a government office was set up, the Office of Export Trading Company Affairs in the Commerce Department, to promote other kinds of trading companies and not ours.

That is their specific mandate. Now, in all fairness to them—and I just wanted to be complete on this—they are perfectly willing to work with us and have said as much. But the purpose of the office, the whole thrust, is to promote two kinds of trading companies—bank trading companies and those trading companies that were set up pursuant to the 1982 Anti-Trust Certification Procedure—not to promote our activities.

We would like to see a different kind of program come out of Commerce, especially at the district office level, where Commerce would encourage small exporters to recognize that an export management company is an alternative. It may not be the one for every small manufacturer, but it's at least an alternative for some of them.

And since we have 500 members in our group and they tend to represent about 10 companies apiece, we're talking about 5,000 manufacturers, about $2.5 billion worth of export.

The Commerce Department has a budget problem. You would be curious to know that the district offices don't even have a budget to subscribe to the local newspapers in the cities in which they're located, or the Wall Street Journal, which is a pretty basic tool of being informed on business.

So we would like to work with the Commerce Department and we invite you gentlemen, if you are interested, to consider our point of view in terms of promoting all kinds of export trading companies, and not simply to encourage two kinds, which, whatever their merits or benefits, are not ourselves.

I'll stop there.

[The complete prepared statement of Ralph H. Chew follows:]

staff in Japan to manage the documentation. I, however, discourage my employees from actively marketing this service because it has a negative impact on the computation of "principally" from exports. ETC's should be allowed to export this and other services and, like the Japanese, we would hire the staff to manage the business.

Another example is related to our countertrade activities. FITC actively pursues a policy of developing exports from countries willing to allow countertrade transactions to substitute for scarce foreign exchange. The only objective of this activity is to develop a mechanism for payment for U.S. goods or to service debt owed to First Interstate Bank. Our efforts in Peru are one example of the implementation of this policy. Last year we made a proposal to Peru that FITC export non-traditional Peruvian products and/or traditional Peruvian products to new markets, and that a portion of the proceeds from such sales be applied to debt owed to First Interstate Bank. In addition to debt reduction, another portion of the proceeds would be used for countertrade transactions. We have been assured by Peruvian government leaders that our proposal will be approved. In anticipation of approval and in keeping with our policy, we are now assisting Peru to export some of its products. The result of this activity is to increase exports of U.S. goods by enabling foreign buyers to earn the necessary foreign exchange through a countertrade mechanism, to reduce debt that is threatening the "safety and soundness" of the banking industry and to increase employment at FITC. FITC has just hired five former Sears World Trade employees to support these and other efforts. Revenues from the third country transactions need to be treated as export-related.

Section 1(a)(2) of S.653 would also exempt ETC's from the collateral requirements of Section 23A of the Federal Reserve Act. FITC has not found Section 23A to be unworkable; however, we understand that Section 23A has presented operational problems to other bank-affiliated ETC's. The July 8, 1983 Amendments to Regulation K include a waiver of the collateral requirements of 23A which reduces the required collateral to "at least equal in value to the letter of credit or advance where the letter of credit or advance is used to acquire goods for which the ETC has a binding resale commitment." Since FITC engages only in transactions where the goods are pre-sold to a qualified buyer, 23A does not present a problem to our firm under the existing regulations due to the nature of our activities.

S.653 would also add a new provision to the Bank Holding Company Act of 1956 providing that a proposed assets-to-equity ration of up to 25:1 shall not, in and of itself, be grounds for disapproval of an ETC application by the Board. We understand that the Board is presently requiring that proposals for an asset-to-equity ratio of greater than ten-to-one be approved in Washington rather than by the applicant's regional Federal Reserve Bank. To the extent that this requirement is intended to discourage higher ratios, I feel that it is unnecessarily restrictive. Although FITC currently maintains a ratio below 10-to-1, we expect to exceed that level as our business continues to expand. For FITC an increase in the ratio will be necessary to allow us to meet return-on-equity targets for First Interstate Bancorp investments while supporting low margin export transactions. A 25:1 ratio would not have an adverse effect on safety and soundness since all of our trading assets consist of goods which have been pre-sold to qualified buyers.

Finally, S.653 addresses the Board's regulatory requirement that applications which anticipate ETC holding inventories in excess of $2 million be referred to Washington. Just as with the Board's assets-to-equity ratio requirement, this requirement has no basis in the ETC Act and discourages applications which envisage higher inventories.

FITC interprets this restriction to apply only to unsold inventory. In the normal course of our business we take title to goods against firm orders, hold the inventory while modifications are made or the goods are otherwise prepared for shipment, and invoice the customer upon shipment. Depending upon the time involved in consolidating the shipment or completing modifications, the level of such inventory will rise and fall, but at no time are we exposed to the risk of sale.

For example, FITC recently participated in the export of three aluminum can manufacturing production lines to China. In each case we had obtained the assignment of the sales contract and consent of the Chinese buyer. In addition, we had been assigned Bank of China letters of credit and guarantees payable upon presentation of shipping documents. We purchased the components from various vendors, delivered them to sub-contractors for assembly and testing, and subsequently shipped them to China. Just prior to a shipment the inventory level could rise to as high as $9 million. If the $2 million inventory restriction was meant to apply to all inventory rather than simply to inventory which is not pre-sold, it would severely impede the conduct of our business. Should any question of interpretation exist, the amendment must be passed for the sake of clarity.

In summary, we support the following changes in the ETC Act:

- o A modified definition of "export trading company" to include revenues from third country transactions as export-related and permit the export of services by ETC's and their affiliates to be included as export-related. Passage would have a positive effect on balance of payments and create new U.S. jobs.
- o Relief from the requirement to obtain approval in Washington, D.C. for increases in the assets-to-equity ratio to a level needed to provide a satisfactory return on equity would encourage bank holding companies to devote additional resources to this area and to more effectively respond to the needs of their exporting customers.
- o Clarification of the $2 million inventory restriction would eliminate any confusion concerning the accumulation of pre-sold inventory in the normal course of business. Hopefully this might encourage other bank-owned ETC's to engage in transactions where they act as a principal to control performance risk.

In conclusion, I would like to express my appreciation for the opportunity to present First Interstate Trading Company's viewpoint on ETC legislation.

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STATEMENT OF RALPH H. CHEW,
GROUP PRESIDENT, CHEW INTERNATIONAL GROUP,
and PRESIDENT
NATIONAL FEDERATION OF EXPORT ASSOCIATIONS (NaFEA)
and the NATIONAL ASSOCIATION OF EXPORT COMPANIES, INC. (NEXCO)

Mr. Chairman, I am very pleased to have this opportunity to present the views of the nonbank ETC and export management company industry. As you may know, export management companies are nonbank ETC's which have exclusive representation agreements with U.S. manufacturers. Export management companies are also known as EMC's. Given their high level of product expertise and international skills, export management companies or EMC's are generally considered the "business elite" of the nonbank export trading company industry.

I am group president of Chew International Group, a nonbank export company which for over 70 years has exported U.S. products worldwide. I have been the CEO of various Chew Group export management companies for 30 years.

The export marketing arm of Chew International Group is comprised of six export companies, each specializing in a particular product line. The core Chew Group company provides, to our EMC affiliates, export service functions in finance, logistics, data processing, banking, credit evaluations, regulation compliance, languages, trademark, controller and accounting; allowing our product specialized EMC companies to very efficiently concentrate on export sales in their product lines.

Chew International Group has its headquarters in New York City, as do many EMC's and, of course, various money center banks. Chicago and California are similarly important national centers for both export management companies and the banking community.

While most export management companies have their headquarters in the New York metropolitan area, Chicago area and California, almost all, like Chew International Group, represent manufacturers and food processors located throughout the United States.

As indicated, export management companies are marketing oriented. But ours is a marketing effort which goes well beyond the marketing activities of domestic sales intermediaries. We provide our suppliers with the information necessary to adapt the domestic product to the requirements of foreign markets. We normally also take title to the goods we export while they are still in the United States, thereby relieving our suppliers of the risks associated with exporting.

Our export management companies are usually product specialists, combining the noncompetitive products of various manufacturers into a product line which is more saleable than the sum of its parts. As a large number of products from many manufacturers will comprise an EMC product line, the EMC can usually market products at a lower cost per product than can the typical manufacturer.

With respect to public affairs, our EMC trade associations in New York City, Chicago and Los Angeles have joined together to form NaFEA, the National Federation of Export Associations. NaFEA has its headquarters in Washington, D.C. and represents over 500 export management companies, and some of the bank ETC's which remain active. (I'm told that there are less than 20 active bank ETC's.) I am president of NaFEA. I am also president of our New York City based trade association NEXCO. (I try not to let all these titles go to my head. My colleagues selected me to be the president of NaFEA, perhaps because I'm tall, or because Washington, D.C. is in the same time zone as New York and a shuttle ride away).

It is our impression that the Carter Administration, the Reagan Administration and Congress believed that Title II of the 1982 Act was important export company legislation, and wasted several years developing it. But after the export difficulties which have beset our nation during these past years, to now again squander congressional and executive branch credibility on a bill limited to narrow, money center bank-oriented special interest legislation, would be a tragedy.

Indeed, these special interest proposals now before Congress, which would primarily benefit a handful of money center banks, should rightly be called "Import Company" legislation. For S.653, by stating that -

> "revenues derived from third country trade shall be considered as derived from the export of a service produced in the Untied States" (page 2)

and also a draft House bill I received labeled STGERM 187 which states that -

> "fees derived from the facilitation, outside the United States, of trade services shall be treated as revenue derived from exporting or facilitating exports to the extent --
>
> (I) the fees so derived are remitted to the United States; and
>
> (II) the aggregate amount of such fees in any year does not exceed one-half the amount of revenue actually derived from export operations or the facilitation of export services" (page 3)

would permit a bank affiliated ETC to engage primarily in a combination of third country trade and importing. This certainly was not the 1982 intent of the Congress.

During the evolution of the Export Trading Company Act of 1982, the export company community informed Congress of our belief that Title II of the ETC Act would prove to be of little value, but NEXCO nevertheless endorsed it. Why?

We understood your public policy focus on banks and their relationships with export trading companies. For aside from difficulties then caused by an overly strong dollar, bank credit practices were and still remain the greatest constraints on growth faced by the export industry. As the problem had been presented by the Conference Board:

Senator SARBANES. Thank you.
Mr. Nelson.

STATEMENT OF JAMES NELSON, DIRECTOR OF GOVERNMENT RELATIONS, UNITED TECHNOLOGIES CORP., COALITION FOR EMPLOYMENT THROUGH EXPORTS AND NATIONAL FOREIGN TRADE COUNCIL

Mr. NELSON. Thank you, Mr. Chairman. While I work for United Technologies Corp., I am testifying on behalf of the Coalition for Employment Through Exports, better known as CEE; and the National Foreign Trade Council, better known as NFTC.

We've submitted a rather extensive statement for the record. I will only summarize a few of the key points. The reason we did put such a statement forward for the record is because a lot of the issues in there deal with what we consider to be long-term issues, policy considerations which are going to be coming up, if they haven't already.

We're not proposing legislation at this point in time. We don't think that's needed. We do think a great deal of study of these issues is needed.

It's been very difficult for the Government to do this kind of long-range planning, so we're trying to bring these issues to the early attention of Congress.

First, I'd like to say we're very appreciative to Congress for the interest that they have shown in export financing issues and, specifically, for the 1986 reauthorization bill, which will allow Eximbank to go forward with a number of good reforms.

1987, THE YEAR OF COMPETITIVENESS

1987 may be the year of competitiveness in Congress, but I think, when history looks back on it, we'll find that the Eximbank reauthorization bill will rank up near the top of all legislation in providing the type of competitivness support that industry needs.

We'd also like to express our appreciation for John Bohn and his staff at Eximbank, who have done a very fine job working with the exporting community. They're aggressively pursuing the reforms mandated by Congress as he outlined in his testimony. They've been dialoging and listening to the exporting community and modifying their proposals as they go along.

This is the kind of Government/industry relationship that needs to develop if we're going to have effective programs.

As John Bohn said in his testimony, Eximbank has put forth some proposals for sweeping program changes. We agree these are sweeping changes and, if properly implemented, will cause exports to increase from this country.

We're encouraged about the parameters of these new programs, but we're also cautious. Any program in Government is difficult to implement because of bureaucratic procedures and other policy issues.

I'd like at this point in time just to highlight two major implementation concerns that we have. One deals with the attractiveness of the guarantee programs to private capital markets, and the

other deals with this concept of differentiated exposure risk fees, which John Bohn outlined in his testimony.

In the 1986 reauthorization bill, there's a provision that provided for unrestricted transfer of Eximbank's guarantees and insurance in the private market.

Why was that law required?

That law was required because there has been a reduction in the amount of private capital going into supporting trade finance. Some mechanism is needed to make the programs of Eximbank more attractive to bring more private capital into the business of trade finance.

Eximbank can't do it all. The Government can't finance it all. They need the private capital market. This law was put into place because everybody in the financial world today wants to move paper. They don't want to hold on to it. They want to sell it.

And their ability to sell that paper allows them to provide lower interest rates. It gets their costs down. Lower interest to our customers makes us more competitive. It also attracts more private capital because these instruments themselves become more competitive.

The issue we are concerned with on implementation is the ability to make the transferability provisions work. There are two issues basically and they're outlined in the testimony in some detail.

One has to do with the mechanics of the transferability. How are these instruments going to be monitored or traded in the private market? As freely as possible is the only guideline we have. Obviously, some rules and regulations are going to have to be set up. And any time you have rules and regulations there are some restrictions, but as freely as possible is the criteria.

GUARANTEE FEE PAYMENTS

Guarantee fee payments is a very sticky issue that I know Eximbank is wrestling with. Whose responsible for making these fee payments? When? And what does that do to the ultimate holder of the guarantee if the payments aren't made? Is he going to be responsible for servicing them?

The second issue, concerning transferability, that affects the attractiveness of Eximbank's programs to private markets is the quality of guarantee itself.

If the quality of the guarantee itself isn't good, nobody's going to want to buy it and it's going to sit with the original holder. The effect of the transferability provision would be negated.

There's a number of issues which affect the quality of the guarantee. Eximbank is very aggressively trying to deal with many of these. We're continuing the dialog with the Bank, so we feel it can be worked out in the long run.

Two of these issues are outlined in the testimony. One is claims payment processing—we must have an expedited claims payment procedure. The ultimate holder of the guarantee must know that on the due date he's going to be able to get his money or very close to it.

The other is the ability to recover full principal and interest from the guarantee and, again, there's some dialog going on with

Eximbank in this area. Some rules concerning how much interest is going to be covered has been developed and the banks are talking to Eximbank to make this more acceptable.

DIFFERENTIATED EXPOSURE RISK FEE SCHEDULE

The second area of implementation that I will briefly outline has to do with the differentiated exposure risk fee schedule. John Bohn, in his testimony, did explain why they went to this system. They went to this system, because the exact same fees were charged no matter how risky the transaction or in what country. Eximbank on the whole has got to at least break even. If they have got to charge the same fees for everybody, they just cannot do business in certain countries. By being able to charge more fees to do riskier business, they ought to be able to do business in more countries and still meet the criteria of being an institution that is self-sustaining.

It is a good concept, and we are supporting Eximbank in going forward on it; however, there is a danger that what we will end up with is a higher fee schedule and no additional risk being taken. The ability to take risk is a cultural thing. Loans officers, economists, everybody at Eximbank has looked at risk one way for a long, long time. To change their concept of how they look at risk overnight is going to be difficult.

We think it will be done, but we don't think it will be done quite as expeditiously as we would like. We think it is moving in the right direction.

The new fees must be also competitive with other countries. I think Eximbank has done a very good job of trying to assure that that is the case.

There are a number of other issues outlined in the testimony. I don't want to repeat anything John Bohn said on the mixed credit issue. I think what he said, we would agree with wholeheartedly. It is a policy issue that has not been dealt with. Mixed credits is a policy issue that must be dealt with by Congress and the administration jointly. Under the current rules and guidelines Eximbank really has very little flexibility to act in this area. The OECD agreement will not stop this practice.

Mr. Chairman, I see my time is up, so I will stop there and take any questions you may have.

[The complete prepared statement of James R. Nelson follows:]

> "The credit policies of many [U.S.] banking institutions and their general reluctance to advance funds on foreign trade receivables inhibit the way in which [American] business is conducted overseas." (President, manufacturing firm, quoted in The Impact of Regulations on U.S. Exports, Report No. 809 of The Conference Board, 1981, p.25).

While bank equity participation in a trading relationship was not seen as a cure-all, we thought bank ETC's would increase bankers' knowledge of the export industry and, presumably, with increased knowledge would come a more realistic evaluation of risk and an increased willingness to finance export trade receivables.

How has the reality of the past few years matched our expectations?

Unfortunately according to a recent National Foreign Trade Council survey -

> "there has been a major decline in the degree to which commercial lenders are interested in providing export finance assistance. This declining interest has been, moreover, reflected in a decrease in trade finance activity among commercial banks."(NFTC Bulletin, 1/20/87, p.1)

To summarize, for various reasons the capabilities of our nation's banks in export finance, already weak in 1982, are now even weaker.

After this record of failure of expectations, both within the bank ETC industry and the nonbank export company industry, where should we go from here? Hopefully you will not rush to just "do something" and include this special interest legislation in the overall trade package now being developed by Congress. For you will assuredly only promote U.S. imports.

Let us instead develop export company legislation which will truly strengthen both bank capabilities in export finance and the U.S. export company industry. Banks, with their weak international sovereign loan portfolios certainly need encouragement, guarantees and other incentives to increase their trade finance activities. And if we can focus these incentives on export companies, we will indeed fulfill the original intent of the ETC Act of 1982. As this committee may already know, many nations target special incentives to export companies, given our economies and efficiencies.

As a first step, I therefore now propose to the esteemed chairman and other members of this committee, as well as to Secretary Baldrige, that you encourage the money center banks of New York, Chicago and California to meet with representatives of the export management communities in their regions to jointly develop the focused incentives banks need to increase their activities in trade finance.

I will provide the introductions even in the Midwest and West, if these should prove necessary. And such introductions may prove necessary because many senior bank managements appear to know very little regarding the export realities of our nation, and who the skilled players really are. The failure of most bank ETC's attests to this unfortunate situation.

Our belief is that EMC's and bank ETC's should not work at cross purposes, so that a serious effort can be made to have amendments to the ETC Act which will provide useful incentives and supports to all kinds of export companies, bank and nonbank ETC's alike.

Our association's testimony, in the Senate, before passage of the 1982 Act, included 10 proposed incentives for export companies. In 1985 I was asked to write an article on export incentives and scaled these down to a more modest seven. This article, published in the Touche Ross study, "The U.S. Trade Deficit: Impact and Implications," is attached. It is the current legislative platform of the nonbank export company industry. However, the incentives proposed also would apply to bank export trading companies.

I would be delighted to read my article, but I think it would take a long time. I'll just put the entire article in the record and thereby make my proposals available for your later examination and evaluation.

To conclude, I seriously believe that a legitimate program directed at all EMC's and ETC's would offer a very cost effective means of increasing U.S. exports. Unfortunately, the current proposals before Congress represent only the special interest needs of a few money center banks. Moreover, the enactment of major elements of these proposals would promote imports, not exports.

Thank you.

Ralph H. Chew
President
Chew International Group

Incentives Needed for Export Development

The U.S. trade deficit can easily lead to a serious crisis if we respond to it with protectionist measures. Many observers agree that the protectionist trade wars of the early 1930s deepened the Depression and helped bring on World War II.

International trade has grown rapidly over the past forty years, and with relatively few restraints. New protectionist policies can destroy this merchandise movement and thus trigger another major depression, with attendant social crises. To reduce our trade deficit, export incentives must be resorted to instead of destructive protectionism.

To ignore the problems of the U.S. export community is both shortsighted and bad economics: the United States normally depends on foreign trade for almost one-sixth of its manufacturing jobs, and one-fourth of its farmland produces for export. An insular economy might well ignore its exports; an interdependent economy does so at certain risk to its long-term interests and domestic economy.

Nevertheless, during the past decade, Washington has negotiated away its only export incentive of real value, the domestic international sales corporation (DISC), and whittled away the budgets of the Commerce Department and other export-promoting agencies. My industry, export management, is particularly dependent on a climate that encourages exports.

Export Management Companies

Export management companies (EMCs) are a vital national resource. They are export specialists in an economy where such expertise is in too short supply.

An export management company offers several efficiencies that a manufacturer usually cannot provide. First, EMCs respond to the needs of overseas buyers by providing complete product lines, culled from several U.S. suppliers. By offering the convenience of "one-stop shopping," for example, EMCs often induce foreign buyers to purchase not only top-quality goods, but also goods that are not themselves truly outstanding or unique but are nonetheless competitive with other nations' products. Second, EMCs can achieve economies of scale in sales and consolidations unavailable to most manufacturers by combining products of several companies. Third, and most importantly, EMCs are foreign-market specialists, expert in the procedures for marketing, shipping, and financing goods in those markets. Even for a large multinational, an EMC can augment sales by developing markets outside the manufacturer's mainstream.

Contrary to popular belief, EMCs normally are not brokers. EMCs take title to goods and usually work on an exclusive basis for their suppliers/manufacturers. Such product-line–oriented export companies have proved their worth to the American economy since the days of the "Yankee Trader."

Legislative Context

During the extended congressional debate on the Export Trading Company (ETC) Act of 1982, our export associations proposed useful incentives for export companies. Unfortunately, the final version of the bill dealt with antitrust matters and allowed banks to enter this business where they do not belong except as joint-venture partners. (In Japan, a bank cannot own more than 5 percent of a trading company; Japan knows something about trading-company–bank relations.)

Many more crucial issues were not dealt with in the act. For example, all U.S. export companies are affected negatively by regulations that prohibit them from performing logistical functions carried out by trading companies in other countries. Furthermore, subsidies were not considered. This is not realistic when foreign export subsidies are widespread.

To promote exports, the United States must reverse the trend toward sacrificing workable export incentives. Granted, we must structure our incentives efficiently to fit our economic system and to fulfill our fiscal responsibilities. We cannot merely copy foreign governments, nor should we seek to outpace them in providing government assistance to our private sector. Furthermore, to be efficient, export incentives must be national; the various state programs are a jumble. Following are seven proposed incentives for export development that attempt to break new ground.

Seven Proposals

1 **Export Apprenticeship Program.** The introduction of any product to the export market must be subsidized by someone in some manner during the first few years. If the EMC is the subsidizer during this period, its contribution is limited by the need to maintain its relationship with the manufacturer long enough to repay this initial investment, which is sometimes difficult in practice. Compounding this problem is the general dearth of export talent in this country, there being few academic programs to train export executives.

I propose that the public sector, foundations, and business schools together underwrite an apprenticeship program. When an export company signs up a manufacturer, this program will provide (1) an apprentice to work in the EMC office, (2) the apprentice's travel expenses, and (3) additional start-up expenses for the new export product. While this program might also be available to manufacturers, the training an apprentice could receive in an EMC office would be superior. In a year or two, the following benefits would emerge: the manufacturer would have its product introduced overseas; the EMC would have started overseas sales without the usual loss; and the now-trained exporter (a newly minted national asset in the form of human capital) would be useful to both the export company and the manufacturer, or to another company.

2 **Deregulation of International Commerce.** U.S. commerce is at a unique disadvantage internationally due to the many federal regulations affecting shipping, freight rates, rebates, sales and shipping commissions, and so forth. Anti-boycott legislation, in addition to being unique to the United States, is excessively burdensome.

As anti-boycott legislation cannot be eliminated for political reasons, I propose that we relieve export companies of the administrative burdens of boycott compliance by placing all our compliance specialists in the Office of ETC Affairs of the Department of Commerce. The public sector could then assume the personnel costs of these unique regulations, and other administrative encumbrances—export licensing and Foreign Corrupt Practices Act problems—could be managed for EMCs in the same manner. (In fairness to the Office of ETC Affairs, it should be noted that since its establishment in 1982 it has emerged as a forceful advocate of private sector initiative, not regulation. For this reason, it may well not wish to become the domicile for regulatory specialists, and another domicile might be necessary.)

Thirty years ago, the Federal Maritime Commission, in trying to protect U.S. freight-forwarding companies from oligopoly, ruled that neither the big three auto companies, then the largest U.S. exporters, nor anyone else with a "beneficial interest" in a cargo, could receive the customary brokerage fee that steamship companies usually paid either the shipper or forwarder. Export companies were ruled to have a beneficial interest, even in instances where they do not take title. Giving forwarders the exclusive right to freight brokerage has effectively stunted the growth of EMCs ever since.

While the Shipping Act of 1984 may legitimately be described as the beginning of deregulation, it barely scratches the surface. Restrictions should simply be swept away. EMCs should be deregulated and allowed the same rebates, group rates, and commissions on ocean freight as other nations' trading companies.

3 **Tax Incentives** As we know, DISCs had the problem of being incompatible with the General Agreement on Tariffs and Trade (GATT). Foreign Sales Companies (FSCs), the substitutes for DISCs, are less of an incentive for new or small exporters than DISCs, but they do appear to have gained acceptance under GATT as a small FSC category. The acceptance by GATT of this category may allow us to devise a more effective GATT-compatible tax incentive program for small-business exports. I propose that EMCs be taxed at a lower corporate rate—for example, the proposed minimum corporate rate of 15 percent—when representing smaller manufacturers.

Small businesses in the United States are immensely creative, producing jobs faster than larger firms. Small businesses could capitalize on the targeted export incentives granted to EMCs and thereby achieve sales development overseas. But to encourage smaller U.S. manufacturers to enter international markets on their own, without the expert assistance of EMCs, would be counterproductive.

4 **Preferred Financing** The Export–Import Bank, even when one counts its Federal Credit Insurance Association subsidiary, is involved in less than 7 percent of U.S. exports. In Japan and Britain, the figure for equivalent government financing is well over 40 percent, and it is higher in several other "must-export" countries. The percentage of Export–Import Bank financing for U.S. EMCs is even lower than 7 percent, perhaps as low as 2 percent. Yet when Brazil and Korea focused their resources on export, one of their most successful incentives was preferential financing for export companies. I propose that similarly useful financing programs be established here, available *only* to product-line–oriented export companies.

We can also learn from other export-subsidy programs. Typical incentives include the exclusion of all value-added taxes from export pricing, direct government subsidy as a percentage of exports, tax credits as a percentage of exports, and pervasive below-market financing. We should target areas of high potential, such as high tech, medicine, agriculture, and other sectors where the United States can compete strongly, thus creating an industrial policy for exports. And GATT compatibility must be dealt with head-on with an equivalency formula. Again, the efficiency of channeling subsidies through EMCs is persuasive, as budgetary restraints limit the size of such programs.

5 **Negotiation of Market Access** The people of the United States are only now realizing that the relative openness of U.S. markets to imports is not matched by Japan or most other countries. This new understanding can provide useful political pressure for negotiating the elimination of trade barriers. The EMC industry in the United States could contribute importantly to detailed, multilevel negotiations carried out by strengthened international staffs of the U.S. Trade Representative, Commerce Department, and Export–Import Bank.

6 **Countertrade** While more talked about than achieved, countertrade is now a crucial tool in exporting U.S. merchandise. The breakdown of the international credit system has left many struggling debtor nations able to pay for imports only by bartering nontraditional exports. The countertrade products offered by Brazil, for example, include a long list of difficult-to-sell products. I propose a 25 percent reduction in U.S. duties on such products as a tool for helping put together these complicated countertrade sales, which are now crucial to the successful export of our merchandise.

7 **Support of Trade Shows** Trade shows are customary and important in most nations. The Baghdad Fair has run for centuries; the Canton Fair has even survived China's intermittent excesses of xenophobia. The leading trade shows for many industries are not in the United States. This is true even for industries in which the United States excels. All trading nations, as well as private companies, participate in these fairs through their governments. Unfortunately, U.S. participation has always been embarrassingly minor. EMCs have even been limited by the government in the number of products they can show in foreign fairs. This pattern should be changed. Federal and state programs should subsidize the participation of EMCs in key overseas fairs by supporting our presentation of new export products. The U.S. government should also subsidize foreign merchants' trips to U.S. conventions, trade shows, and meetings. We are one of the few trading nations that does not do so.

Conclusion

Those who say nothing can be done do not understand the problem. Our exports are being destroyed; U.S. trade deficits are increasing.

Strengthening the competitiveness of our exports is crucial if our domestic economy and international economic stability are to be preserved. We must act and act now, even if our efforts have only a marginal effect at first.

EMCs can lead the way to a broad industrial recovery through export expansion in the most cost-effective way. Targeting incentives to experienced EMCs will clearly provide the best use of scarce resources.

Additional Reading:

Ralph H. Chew. "Export Trading Companies: Current Legislation, Regulations and Commercial Bank Involvement." *The Columbia Journal of World Business* (Winter 1981): 42–48.

——— "Bank-Backed ETCs: Good or Bad for U.S. Exporters?" *Export Today* (Summer 1985): 41–43.

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TESTIMONY BY

JAMES R. NELSON

UNITED TECHNOLOGIES CORPORATION

ON BEHALF OF

THE COALITION FOR EMPLOYMENT THROUGH EXPORTS

AND

THE NATIONAL FOREIGN TRADE COUNCIL

ON

THE PROGRAMS OF THE EXPORT-IMPORT BANK OF THE UNITED STATES AND

RELATED ISSUES

BEFORE THE

SENATE BANKING COMMITTEE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

March 25, 1987

Good morning, Mr. Chairman.

My name is Jim Nelson and I am Director-Government Liaison for United Technologies Corporation. I am testifying today on behalf of the Coalition for Employment through Exports, better known as CEE, and the National Foreign Trade Council, also known as NFTC. I am accompanied by Bruce Talley, Executive Director of CEE, and Will Berry, Vice President of Legislative Affairs for NFTC. They are available to answer questions, but will not make a formal statement.

CEE is a non profit coalition made up of 50 export oriented companies which derive a significant portion of earnings through the export of U.S. goods and services, 14 labor unions whose members are heavily dependent on export sales for their jobs, and a number of governors who recognize the importance of exports to a healthy American economy. NFTC is the oldest and largest association formed to address trade and investment issues, with more than 500 company members who account for more than 70% of U.S. exports. It is somewhat unusual for one individual to testify for two groups. However, in the interest of limiting the number of witnesses, and the fact that CEE and NFTC positions are similar on matters concerning the subject of these hearings, we felt a unified testimony would be of benefit to the Committee.

My personal experience with United Technologies includes several years in the international marketing division of Pratt & Whitney Aircraft. I also spent one year working for the Export-Import Bank as part of a government-industry exchange program known as The President's Commission on Executive Exchange. In my current capacity I represent the international policy interests of United Technologies in Washington, D.C. United Technologies Corporation is a multinational manufacturer serving the aerospace, defense, building systems, automotive and communications markets. Its products include: Pratt & Whitney jet engines; Sikorsky helicopters; Carrier air conditioners; Otis elevators; Norden radar and command and control systems; Hamilton Standard propellers, aerospace control systems and space suits; electronic systems and wiring harnesses for automobiles; Essex electronic and communications wire and cable; and components and controls for the automotive and industrial sectors. United Technologies has some 180,000 employees and operates in over 50 countries worldwide. Approximately 40% of its $15 billion in sales are derived from international customers, the majority of these being exports from the United States.

Senator SARBANES. Thank you very much, Mr. Nelson.

I have had a chance to look through your statement. I must say it is a very high quality statement, and we appreciate the benefit of this very carefully developed analysis you've done of the issues. I take it at the moment you share the view of John Bohn that there is no pressing matter for legislative adjustment in this area; is that correct, that relates to the Export-Import Bank?

Mr. NELSON. That is correct, Mr. Chairman.

IMPLEMENTATION PROBLEMS

Senator SARBANES. You've outlined implementation problems that are obviously of consequence, but at the moment the action taken last year provides a proper adequate statutory framework in which we can work.

Mr. NELSON. Yes, Mr. Chairman. I would make one qualification on that. In the latter part of the testimony, we do outline seven or eight issues which we think are long-term issues that need study, and we do believe there may be some legislation required in those areas down the road, not at this time.

Senator SARBANES. Thank you very much.

Mr. Rosenberg, I just have a couple of questions.

In a sense, you are the model kid at school.

Where do you fall in the 50-percent requirement of the Fed?

Mr. ROSENBERG. We stay just about at the 50-percent export. We are always at the point where we have excess of exports over imports, but we have managed that very carefully, and that is probably one of the more difficult parts of what I have to do in managing a trading company, because our method of marketing our services is to make our services available through our bank's international departments and the commercial lenders who have transactions that need assistance, and they bring to us as many import transactions as they do export transactions. And we have to filter those out and take only those that we see as providing benefits to exporters.

Senator SARBANES. If that requirement wasn't there, would it be safe to say that the pressure would be on you to drift away from the focus and the amount of impetus that you give to American made exports would diminish?

Mr. ROSENBERG. In our particular case, I am not so sure that that would happen, but you're absolutely correct. Without that requirement, there would be a temptation on the part of many organizations to drift away and take the easier course.

I have to say it is much easier to facilitate imports than exports.

Senator SARBANES. Now, I take it your practice of having all your trading assets consist of goods which have been presold to qualified buyers is not standard, in fact, it is somewhat unique; is that correct?

Mr. ROSENBERG. No, I don't think that is unique. I think that was the intent of other trading companies as well. I think it has been a matter of practice or a matter of performance, where in some cases where they thought they had sales, they ended up that they did not have sales.

Senator SARBANES. Do you think that the Fed, leaving aside what the ratio is, has to have, at least as a start, some operating guide as to a ratio?

Mr. ROSENBERG. I think that what we really need, in terms of a ratio, is to be allowed to operate at the same kind of a ratio as our parent banking organizations operate at. There could be, in fact, some liberalization from that. Where we are operating in the manner that we are, the safety and soundness becomes a relatively unimportant issue, because we are operating under a presold situation. The goods are always presold, and we have control of those transactions.

The leverage issue is simply to allow us to become more competitive when we are dealing in competition with a Japanese or Korean trading company.

I will give you one example of an actual situation. We exported three aluminum can plants to China last year. One of those was sold to a leasing company, which was a joint venture leasing company with a Japanese trading company. The Japanese trading company was also bidding for the sale of that particular aluminum canning plant and put every impediment possible in the way of our customer achieving that contract, and as a result, it was necessary for us to work on a very thin margin to facilitate that transaction.

Had we, at that time, been faced with coming up against one of those ratios, and we have not yet reached the 10 to 1 ratio, if we had been faced with that at that time, we would have been tempted to forego that business, simply because the profitability would not have been acceptable.

Senator SARBANES. Except Mr. Johnson said this morning that they approved as high as a 17 to 1 ratio.

Mr. ROSENBERG. Yes. That is why I have said we have not needed to apply for that. I expect we will exceed that sometime later this year.

Senator SARBANES. So why would you have foregone it? Wouldn't you just have sought to get a better ratio?

Mr. ROSENBERG. I was only using that as an example. If we had been faced with a problem, they could not have responded. The Federal Reserve could not respond in the time necessary for us to make that decision and move ahead on that transaction.

Senator SARBANES. Would you develop your inventory remarks a little bit, the ones on the next to the last page.

Mr. ROSENBERG. In our instance, as we understand the Federal Reserve's guidelines, the $2 million inventory limitation would apply to inventories purchased for resale without a firm contract of resale. We simply do not engage in that kind of a business, which, in our opinion, is speculative. The price is going to change. There is a potential for price change at any point in time, so we don't engage in that kind of transaction.

Our understanding is that in the normal course of our purchase and selling of product which is already contracted for, that those inventories do not fall under the $2 million limitation.

Senator SARBANES. So if that is the interpretation, there is no problem?

Mr. ROSENBERG. That is correct.

Senator SARBANES. And I take it, in your situation, that would certainly be a reasonable interpretation that you had a firm contract for resale, that you ought not to count on the $2 million figure. I mean, at that point.

Mr. ROSENBERG. That is correct.

Senator SARBANES. This is just a cautionary concern. You've not experienced a problem and don't anticipate one.

Mr. ROSENBERG. That is right. We have been examined by the Federal Reserve under that, why we had transactions of that sort under way and have been found to be in compliance on all points.

Senator SARBANES. Mr. Barovick, is there a sense on the part of the Federation of Export Associations that they're being unfairly competed with by the new entrants into the export promotion business?

Mr. BAROVICK. No. I wouldn't say so, no. Clearly, there was uneasiness in 1982, when the act was passed, that it simply created more competition for our industry. As luck would have it, with the exception of my friend on the right, the banks have hardly done a whole lot, and he has actually helped small business exports by making transactions possible.

It could be, over time, that the antitrust side would bring more joint export ventures into the field and be somewhat competitive.

I don't think to date that has been a concern. It was early on, obviously, since our industry was not given recognition at the time, and anybody who came on stream was competition. There was an uneasiness, but no problem.

Senator SARBANES. Gentlemen, the time has come to go, because that bell indicates some votes.

Let me just indicate this follow-up question to you.

U.S. BANKS UNWILLING TO PROVIDE EXPORT FINANCE ASSISTANCE

In your statement, Mr. Chew, the president of your organization makes a point about the unwillingness of U.S. banking institutions to provide export finance assistance.

To what do you attribute that?

Mr. BAROVICK. Several factors. Obviously, the banks got burned in foreign lending, so they are very reluctant to take country risks. No. 2, in the case of our industry, we are dealing in small transactions, and the banks' response to that is that they are more interested in dealing with large companies, where the costs of processing the transaction may be the same for a $50 million as for a $50,000 deal. So it is more profitable for the banks to go to the larger companies to do business with.

COMPLETELY UNDERSTANDABLE

On the other hand, a number of the banks, a lot of them, including some of the big New York money center banks, dismantled their export credit departments in recent years, and all over the country we have the same picture, with some exceptions. There are a number of banks dotted around the country that are still engaged in export credit operations. But it is expensive to maintain an export credit department, specialized people. If there is no business to be done, they drop it as an unprofitable activity.

Today I would like to discuss the current state of government programs that support financing for U.S. exports, particularly those of Eximbank, and then focus on some long term policy issues which will require attention over the next few years.

In late 1985, both CEE and NFTC put together working groups to develop recommendations to Congress and the Eximbank on how the current programs of the Bank could be improved. While CEE and NFTC were interested in the major rechartering issues, NFTC gave special emphasis to the operations of Eximbank and how they affected U.S. competitiveness. A parallel concern was with program changes which would encourage banks to become more active in trade finance. A disturbing trend has been developing over the last several years in which a number of banks have exited from the trade finance market altogether, and others have dramatically cut back their trade finance activity. This trend is the result of lower returns realized from trade finance and the availability of other forms of less risky financing activity. On May 15, 1986, NFTC forwarded two letters to Eximbank recommending a series of changes to its programs and operations. The recommendations contained in these letters were the result of several months of discussions and consultations between banks and exporters.

Simultaneously, CEE was developing recommendations for Congress as it considered the Eximbank Reauthorization Bill. These recommendations were developed by a working group of its membership and focused on the competitiveness of existing Eximbank programs. On February 6, 1986, CEE sent a letter to members of the Senate Banking Committee outlining its recommendations for reauthorization. Because of the similar interests of the two groups, many of these recommendations parallel those submitted by NFTC to Eximbank.

The response of Congress to the recommendations of NFTC and CEE was very positive. The final Eximbank Reauthorization Bill gave clear direction to the Administration in many areas in which the Administration had been reluctant to act in the past. While the entire bill had many positive features, I would like to draw attention to three that were particularly significant.

1) Transferability. Congress directed the Administration to provide for the unrestricted transfer of Eximbank guarantees and insurance. This provision should enhance the value of these instruments in private capital markets, having the effect of lowering interest rates and drawing more capital to support trade finance. The Administration had not been willing to allow Eximbank's guarantees to be sold in private capital markets for fear the guarantees would compete with its own fund raising efforts.

2) Medium Term Program Enhancements. Congress directed Eximbank to make the medium term program as competitive to exporters as that of the long term program. In effect, Congress was directing Eximbank to merge the medium and long term loan and guarantee programs, an improvement advocated by the exporting community. While Eximbank had been desirous of moving in this direction, this legislated requirement helped them in obtaining interagency approval.

3) Tied Aid. The Reauthorization Bill authorized a $300 million Tied Aid Credit Program. This program would be administered by Eximbank, and could be both offensive and defensive in nature. The Appropriations Bill eventually only allowed $100 million for this program, and only if there is unused authority anticipated by Eximbank. However, it does provide Eximbank with possible relief from funding mixed credit proposals out of their reserves. I will address the mixed credit issue later in my testimony when I discuss long term policy issues.

The Reauthorization Bill allowed Eximbank to go forward with several major changes to improve the competitiveness of their programs. However, the 1983 Reauthorization Bill also had provided for major changes which, in the opinion of many exporters and banks, were not implemented in a manner which improved competitiveness, thereby negating the effectiveness of reforms that the bill intended. While the jury is still out on implementation of the current legislation, it is our feeling that Eximbank will fully respond to the needs of the exporting community. Under the leadership of its Chairman John Bohn, Eximbank has aggressively pursued program changes with a clear focus on their net impact on exports. They have proposed program changes which address almost every recommendation made by both NFTC and CEE in their 1986 letters. Eximbank developed an initial set of proposals and discussed these with banks and exporters. The Bank continues to refine these proposals with the advice of program users. We are encouraged by the parameters set forth by the latest proposals unveiled by Eximbank which positively responded to most of these concerns, despite some initial resistance from other Executive Branch agencies responsible for coordinating Eximbank policy.

While Eximbank is aggressively pursuing changes mandated by legislation, and recommended by the exporting community, it is instituting one major change on its own. Through extensive discussion with exporters, and over initial opposition by several government agencies, Eximbank is developing a system of determining fees based on risk exposure. There are some concerns about whether or not this system can be made to work. However, if successfully implemented, this new fee structure would allow Eximbank to take more risk in marginal countries because the risks will be offset by higher fees. Willingness to take additional risk should result in increased exports. This system should positively respond to a consistent complaint by exporters that Eximbank is closed in certain countries. Because of the increased fees for higher risk categories, this system should not compromise Eximbank's requirement to operate as a self sustaining institution.

The new program changes announced by Eximbank must still be implemented. New procedures need to be developed to handle the restructuring of Eximbank's programs. Additionally, new forms must be developed, new guidelines published, loan officers trained, banks and exporters educated and conformance with other government rules and regulations checked. These activities will have to be closely coordinated with the exporting community to insure the programs are workable and still meet the programs' intended objectives. Several discussions between Eximbank and the exporting community have uncovered a few areas of potential concern. NFTC forwarded a letter to Eximbank on February 18, 1987 outlining many of these concerns. Eximbank had already positively responded to several of the items in that letter, and discussions are continuing on the others.

There are two major areas of concern regarding implementation that remain. The first deals with issues that affect the attractiveness of Eximbank's guarantee to capital markets. The second involves the willingness of Eximbank to take additional risk for additional fees. Let me briefly expand on these issues:

1) Transferability. The following four issues are examples of some of the implementation concerns which affect the attractiveness of Eximbank's guarantees to capital markets.

a) Mechanism. The reauthorization legislation provides for unrestricted transferability of Eximbank's guarantees and insurance. Unrestricted in the literal sense means no rules or regulations governing the transfers. Obviously, some mechanism must be developed that is both workable and cost effective. It will be important to insure that this mechanism essentially provides the flexibility to package the guarantees attractively and trade them as freely as possible.

b) Payment of Guarantee Fees. Responsibility for payment of guarantee fees in a fully transferable guarantee must be clearly delineated, or the value of the guarantee will be substantially reduced. The holder of the guarantee in the secondary market does not want to have to depend on payment of fees by the initial holder to insure that the value of the guarantee is maintained. Conversely, the purchaser of the guarantee in the secondary market does not want to be burdened with servicing the guarantee.

c) Payment of Claims. It is very important, particularly to capital market investors, that claims be paid on a timely basis. Any delay in payment after the due date will depreciate the value of the guarantee in the secondary market, and increase the interest rate of the initial loan. Current Eximbank policy requires a period of notice to the borrower which would delay such payments.

d) Interest Rate Cover. Eximbank reduced the amount of interest rate cover on both floating and fixed rate loans. Because of this reduction, investors and lenders would lose in the case of a default not only the interest rate spread but a portion of the loan principal. The risk associated with this change in coverage will result, especially where floating rate funding is required, in a reduced interest by investors and lenders in Eximbank paper (except where the most creditworthy borrower is involved.)

2) Differential Risk Exposure Fees. The concept of differentiating fees on the basis of risk is sound, provided that additional exports result from the ability of Eximbank to take greater risk. The fees also need to be competitive with those of other export credit agencies. This initiative by Eximbank is welcome, but implementation will be difficult. Ultimately, the success of this approach rests with the ability of the staff of Eximbank to adapt their concept of risk to the new parameters and to influence the risk sensitivities of the Board of Directors.

Again, I would like to reaffirm that Eximbank is working closely with banks and exporters in developing its implementation program. In fact, since January Eximbank has already refined its position on several issues based on these consultations. We have every confidence that they will respond as favorably during implementation as they did during the program development phase.

I would now like to turn from current programs and their implementation to some long term issues which are already beginning to reshape export financing requirements. Some of these issues can be easily addressed through adjustments to existing programs. Others will require much more study and discussion before any final recommendations are made. The major policy issues are summarized below.

Assumption of Risk. Eximbank has operated under the premise of reasonable assurance of repayment for assessing risk. Under its new exposure risk schedule, this criterion will be changed to reasonable expectation of repayment. However, the current risk structure favors sovereign risk, which is driven by country risk. It will become necessary for Eximbank to move from a country risk orientation to a system that also evaluates commercial risks as a basis for determining reasonable expectation of repayment. A related form of risk analysis would allow more support for projects in developing countries. Project financing based on the merit of the individual project is increasingly used by lending institutions on a worldwide basis. A study of both the need for using these forms of risk, and Eximbank's role, would help clarify appropriate policy.

Less Developed Country Support. Economic conditions in many LDC countries, and in some cases U.S. economic policies, will not allow Eximbank to support transactions under the reasonable expectation of repayment requirement. When Eximbank's foreign counterparts have less stringent requirements, the net result is lost business for U.S. exporters and more business for the competition. Perhaps a new risk category is needed to cover LDC countries, short of outright aid being provided. This category may, of necessity, be a net cost to Eximbank, although eventually Eximbank would be repaid. A study needs to be completed on the expected cost of such a program versus the benefits to the United States from keeping a strong presence in those markets. Funding of such a program under current budget constraints is also a problem that will have to be addressed.

Trade and Aid. Although an OECD agreement has finally been reached that increases the minimum aid element in a mixed credit transaction to 35% by July 1988, it is generally believed that the practice of mixed credits will continue. In the first quarter of 1986, Japan had mixed credit offers of over $1 billion in key markets such as China, India and Indonesia. Aid is an extension of export support programs for most developed countries outside the United States. We should seriously and expeditiously evaluate how our aid funds are being used, and the net benefits the United States derives from such funds. Such an analysis would allow us to determine whether or not some policy adjustments should be made to our aid programs to bring them more in line with the policies of other exporting nations. We are clearly losing business in key markets today due to our reluctance to seriously address this issue. Efforts to address this issue in legislation is bringing to the surface policy differences between he Administration and Congress.

Leasing Versus Purchasing. Tax law changes, cost of capital, debt burdens and other economic factors are causing many capital intensive companies to evaluate the advantages of leasing versus purchasing. This is particularly evident in the airline industry. Eximbank has responded positively with new leasing programs in both its normal bank programs and through FCIA. However, as leasing and purchasing options become more creative, and alternate forms of financing are developed, government programs need to become more flexible. Asset based financing, where the equipment itself provides the primary collateral, and export credit agencies provide a back-up guarantee, is one unique form of financing that applies to readily recoverable products such as aircraft. Additional programs will have to be explored as innovative financing arrangements continue to be developed.

Foreign Content, Local Content, Cofinancing. Business is becoming increasingly internationalized. International teaming agreements, development of foreign sources of materials and coproduction requirements are causing products to become internationally produced in order to remain competitive. Other developed countries have recognized this trend and adjusted their export financing policies to competitively respond to this challenge. To address the issue, Eximbank asked its Advisory Committee, made up of both union and industry representation, to advise on an appropriate foreign content policy. These recommendations were recently submitted to Eximbank, and are briefly summarized below.

1) Foreign content financing should be allowed up to the level of the minimum downpayment (currently 15%) for medium and long term programs. Additional foreign content should be considered on a case by case basis only if there is a clear and long term economic advantage to the U.S. in doing so.

2) Three issues related to foreign content are important to the competitiveness of U.S. exporters. Programs and policies to deal with these issues should be aggressively pursued by Eximbank. These issues are:

a) Local content financing. Local content is that portion of the product produced in the purchasing country. Coverage of local content is a common practice of certain export credit agencies. Eximbank needs to develop a local content policy which is consistent with its overall foreign content policy, and is competitive with other export credit agencies.

b) Value added, or shipments from, a third country. Many products pass through distributors for minor packaging. Certain stand alone products which are part of a total U.S. sale, are shipped directly from a third country to the buying country without passing through the U.S. Eximbank does not generally cover these situations, and should develop a competitive policy to do so.

c) Confinancing. With more and more products produced by international joint ventures, it is important that Eximbank pursue arrangements with other export credit agencies to jointly finance their own portion of each product.

Cofinancing is a particularly difficult issue to deal with since other countries often cover the U.S. content of their products in order to make a sale. However, some forms of cofinancing, such as providing back-up guarantees as part of an asset based financing transaction, may be easier to pursue. Coinsurance transactions to cover leasing arrangements may be better handled through an international insurance association such as the proposed Multilateral Investment Guaranty Association (MIGA). MIGA cannot become operational until Congress approves the U.S. share of its participation. Full U.S. participation is being supported by NFTC and several other trade associations.

Exporter Support System. As more and more U.S. companies enter the international business arena, systems to distribute export financing programs to exporters will become increasingly important. In fact, an argument could be made that if we had an effective distribution system for these programs, more companies would be involved in exporting. Eximbank's restructured guarantee programs are an important first step in trying to attract additional lending institutions to trade finance. However, the availability of information concerning Eximbank programs is limited, and Eximbank is not staffed to properly promote their programs or to work directly with a large network of banks. Furthermore, companies selling overseas need a strong network of foreign assistance offices to help them secure credit on small sized, short and medium term transactions. This type of support will be particularly important if more nonsovereign business is going to be conducted. The expense to develop such a system could be prohibitive, but other export credit agencies do it very effectively. We should at least be able to make our existing system of government field support more responsive in this area.

Structure of Government Support. Economic and political pressures on the U.S. government are causing changes which will impact government export financing issues. Federal deficits have put pressure on increased spending cuts. As a result, there is a trend toward privatizing certain government programs. Outside political pressure from groups concerned with our trade deficit, and production declines in certain industries, have an impact on government policy. At the same time the reserves of Eximbank, as a result of negative interest differentials on previous loans, are rapidly declining. The recent trend to sell Eximbank assets is accelerating this decline. Although not the subject of this testimony, NFTC and CEE are opposed to this practice because we believe it is poor fiscal policy. All of these factors raise questions about how Eximbank will be structured, and whether it will continue to be a bank, or whether it will be primarily a facilitator. These issues may come to head next fiscal year when Eximbank's reserves will drop below 50% of their authorized level. New credit budgeting techniques proposed by the Administration may also precipitate serious attention to be given to these structural issues. We do not have any specific recommendations at this time, but we will be developing our position throughout the year.

Insurance. The role of the Foreign Credit Insurance Association (FCIA) is being examined as a result of last year's legislation. Since the majority of Eximbank's business is through FCIA, the

competitiveness of FCIA's insurance programs is very important to any effort of the government to improve the competitiveness of export financing programs. FCIA is also important because a lot of its business is focused on the small and medium sized exporter. The role of Eximbank, FCIA and the government in the market for reinsurance also needs to be explored. This has been discussed in the past, but no serious study of reinsurance and its potential impact on trade has been completed. The GAO is currently conducting a study of FCIA which hopefully will address these issues.

Industry Sector Expansion. There are several markets where Eximbank is not currently active either because of the nature of the Bank's products, or because of legislative restrictions. Two important sectors are:

1) Defense Products. The U.S. is rapidly losing its market share of worldwide defense exports due to competitive pressures. Most of these exports are high technology products, and this loss of market share spills over to the private sector. The Arms Export Control Act specifically prohibits Eximbank from providing support for defense equipment and services to economically less developed countries. However, every other major defense exporting country supports its defense exports through its official export credit agency. The current U.S. restrictions should be reviewed to determine their impact on U.S. competitiveness and the trade balance, and certain restrictions to our allies and other friendly countries should be removed. NFTC has been actively addressing this issue and will be making recommendations on such changes.

2) Service Sector. The increasing international competitiveness of the service sector will require special attention and special programs. Service sector financing requirements are very different and vary much more than those of Eximbank's traditional programs which support primarily manufactured goods. While the U.S. continues to be very competitive in many service oriented industries, it is being challenged by foreign competition which is supported by their governments.

Countertrade and Barter. These forms of financing are on the rise, however, we do not have any government financing programs that adequately deal with them. It is a very complicated business where intrinsic values are not well defined. However, countertrade and barter may become very acceptable and common forms of doing business with less developed countries. The role of government, and Eximbank in particular, in providing some form of securitization for these deals should be studied to determine the costs and benefits.

These are some of the issues which need some focus over the next several years if U.S. government export financing programs are to remain competitive with those of other countries. We look forward to addressing these issues with Congress, the Administration and Eximbank in developing policy positions which are both politically feasible, economically responsible and consistent with our trade policy requirements.

Mr. Chairman, this concludes my testimony. I will be happy to answer any questions you may have.

If the banks are going to be deregulated, they are looking, therefore, more to the bottom line, and they don't want to be bothered with trade finance.

I have to just add one more sentence. The gap has been filled by the foreign banks in the United States. No mistake about it. Big European and Japanese banks have moved in and set up a nationwide network, which is awesome to look at, and they are filling much of the gap.

Senator SARBANES. Gentlemen, thank you very much. It was a very helpful panel. We appreciate your contribution and the obvious work that went into the statements.

Thank you.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[Response to written questions follow:]

SENATOR HEINZ
QUESTIONS FOR KEN ROSENBERG

ANSWERS BY KEN ROSENBERG

1(Q) You indicated that you discourage facilitation of third-country deals because of current Federal Reserve application of the revenue test. If you were permitted to pursue these deals, what are the typical opportunities you would pursue? What share of your earnings would you expect to earn on this basis? To what extent would you expect should deals to lead to U.S. sales, or would they likely dominate or displace U.S. business you might do otherwise?

(A) Typical third-country transactions we would pursue with modification of the revenue test would be:

A. FITC currently imports hardwoods from Peru for the purpose of creating counter-trade opportunities for U.S. suppliers to Peru. In some cases our Peruvian buyer has indicated a desire to purchase tractors from Brazil for economic reasons. FITC could arrange the counter-trade transaction which would then create an opportunity to sell an equivalent value of U.S. goods to Brazil in a second counter-trade transaction. Under current rules the export revenue test results would be as follows.

Transaction	Export Revenue	Other Revenue
1.) Import of hardwoods from Peru		$100.00
2.) Peru purchases Brazilian tractor		$100.00
3.) Brazil purchases U.S. Telephone equipment	$100.00	
	$100.00	$200.00

SENATOR HEINZ

QUESTIONS FOR KEN ROSENBERG

(A) Typical third-country transactions we would pursue with modification of the revenue test would be: (continued)

To achieve a balance FITC must create an additional unrelated U.S. Export. #2.) Results in repatriation of foreign held dollars (a postive balance of payments effect) and is an export of an FITC service. And #3 accomplishes our intent of assisting a U.S. exporter to sell in a difficult market.

No more than 20% of our total export revenue would be derived from the third-country transactions of this type.

B. More common are opportunities to act as an intermediary in third-country transactions where buyer and seller have no formal diplomatic or trade relations. South Korea and the Peoples Republic of China are a prime example. While there is no official contact between the countries there is, in fact, a thriving trade facilitated primarily by Japanese and Hong Kong trading companies. U.S. suppliers of products cannot effectively compete with either party due primarily to shipping costs and labor rates. FITC could, however, create U.S. jobs in trading activities and earn foreign exchange by exporting it's own service of trade facilitation. The resulting revenue is currently treated as non-export and therefore we do not pursue this business. Aside from the direct profit benefits, participtation in these transactions raises our visibility as a serious international trading organization and thereby enhances our ability to facilitate additional U.S. exports. It also gives us the opportunity to suggest U.S. products where competitive. With a change in regulation this type of third-country transaction could provide up to 20% of export revenue.

SENATOR HEINZ

QUESTIONS FOR KEN ROSENBERG

(A) Typical third-country transactions we would pursue with modification of the revenue test would be: (continued)

B. Neither of the transactions described above would have a negative effect on the export of U.S. products but rather would either directly or indirectly facilitate additional U.S. exports. FITC would not reduce its efforts to encourage U.S. export but would be better able to finance additional marketing activities on behalf of U.S. manufactures.

2(Q) Since your firm deals only in goods "pre-sold to a qualified buyer," you see no problem for your firm with the current inventory limit or application of collateral requirements. Are there alternative modes of operation that might be attractive but which would run up against these limits? Do you now pass up business because of regulatory concerns?

(A) There are alternative modes of operations that might be attractive to other bank-affiliated trading companies. Some of the "money center" banks appear to be using their ETCs to market traditional trade finance services to small and medium size exporters. The related bank does not serve the smaller exporter in its normal banking activities but an ETC may find it attractive to do so. In this case the ETC may not wish or need to take title to the product to facilitate the transaction. The ETC then becomes a direct lender to the exporter and must fund itself with borrowings from the affiliated bank. Application of the collateral requirements of Reg. 23A makes this activity impossible.

FITC does not engage in business of this sort and therefore does not pass up business because of regulatory concerns.

SENATOR HEINZ

QUESTIONS FOR KEN ROSENBERG

3(Q) You indicate that your firm will soon breach a 10:1 leverage ratio and already, at times, breaches a $2 million inventory limit if narrowly interpreted. Do you see present regulations constraining your future growth? Were they perceived as a problem in your start-up period? Is Federal Reserve response time such that arbitary levels have a chilling effect on start-up or expansion decisions?

(A) Present regulations are very likely to constrain our future growth. In particular the 10:1 leverage ratio will make it difficult to facilitate low-margin transactions even though the risks may also be low. We suggest that the ETCs be allowed to operate at a leverage ratio that would not exceed that of its affiliated bank(s). It seems to me this would be a reasonable compromise that should be acceptable to the Federal Reserve and the ETCs.

During FITCs start-up period the Federal Reserve regulations did not pose a serious constraint. We concentrated on developing export business, dealt only in pre-sold product transactions and took on import business only when justified by export volume.

Federal Reserve response time has not been a serious problem for FITCs start-up or expansion decisions. We have had no need to seek approval of our expansion activities since we have not undertaken new activities not included in our original application. We did consider a possible joint venture that would require Fed approval and included in our planning a 60 day response time. Our decision to forego the joint venture was not affected by the projected Fed response time.

SENATOR HEINZ
QUESTIONS FOR KEN ROSENBERG

In conclusion we support an amendment to the ETC Act that would: 1.) Define third-country transactions where fees earned are returned to the U.S. as export of services allowed under the Act. 2.) Allow ETCs to export their own services and services of their affiliates. 3.) Raise the 10:1 leverage ratio to somewhere between 15 and 25:1. 4.) Eliminate the arbitary $2 million inventory restriction.

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